

CREDIT RATING AGENCY (“CRA”) REFORM as of July 2011

Title IX of the Dodd-Frank Act significantly expands the SEC’s oversight of credit rating agencies (CRAs), while at the same time altering the use of credit ratings in a broad range of legal requirements and impacting the public disclosure of credit ratings in securities offerings. The SEC has commenced rulemaking to implement its oversight authority through a series of rules regarding required disclosures in connection with credit ratings, prohibited activities, governance, internal controls and conflicts of interest. Various federal agencies have also identified those rules which reference credit ratings, and are in the process of substituting alternative standards of creditworthiness in place of those ratings.

Oversight

- Establishes the SEC’s Office of Credit Ratings, which is responsible for the SEC’s rules applicable to CRAs (this Office has not been staffed due to budget considerations).
- The SEC will conduct an annual exam of each nationally recognized statistical rating organization (“NRSROs”) and make its inspection reports publicly available.

Liability

- Eliminated the exemption from the consent filing requirement for registration statements that was provided to NRSROs in 1933 Act Rule 436(g), relating to liability under 1933 Act Section 11.
- Duty to report violations of law to appropriate authorities.
- Enforcement and penalty provisions of the 1934 Act apply to CRA statements to the same extent as registered public accounting firms or securities analysts.
- Modification to “state of mind” requirement for private securities fraud actions against CRAs for money damages.

Governance

- The board of directors of the NRSRO has specifically mandated oversight responsibilities with respect to policies and procedures for determining ratings, conflicts of interest, and internal hiring and promotion.
- At least half of the NRSRO board of directors must be comprised of independent directors (no fewer than two), with a portion of such directors to include users of ratings.
- Independent directors to serve for a fixed, non-renewable term not to exceed five years, with compensation not linked to the business performance of the NRSRO.

Transparency, Conflicts of Interest, and Process

- The SEC is addressing various aspects of the credit rating agency process through rules proposed in May 2011, including: (1) internal controls and procedures; (2) conflicts of interest; (3) credit rating methodologies; (4) transparency; (5) ratings performance; (6) analyst training; (7) credit rating symbology; and (8) disclosures accompanying the publication of credit ratings. The comment period for those proposed rules closes on August 8, 2011.

Removal of Ratings

- Requires the removal of certain statutory references to credit ratings effective two years from enactment.
- Directs federal agencies to review and modify regulations to remove references to, or reliance on, credit ratings, and to substitute an alternative standard of credit-worthiness. The SEC proposed rule changes in 2011 to eliminate references to credit ratings, and these rule changes have not yet been adopted.

Studies

- The SEC is required to study the feasibility and desirability of: (1) standardizing credit rating terminology; (2) standardizing the market stress conditions under which ratings are evaluated; (3) requiring a quantitative correspondence between credit rating agencies and a range of default probabilities and loss expectations under standardized conditions of economic stress; and (4) standardizing credit rating terminology across asset classes.
- In December 2010, the SEC requested comment on its credit rating standardization study, and the comment period is now closed. In May 2011, the SEC requested comment on a study with regard to assigned credit ratings, and comments on this study are due by September 13, 2011.