

**SECTION-BY-SECTION
CREDIT RATING AGENCY DISCUSSION DRAFT
AS OF SEPTEMBER 25, 2009**

Sec. 1. Short Title

- Provides the short title of the bill as the “Enhanced Accountability and Transparency in Rating Agencies Act.”

Sec. 2. Enhanced Regulation of Nationally Recognized Statistical Rating Organizations (changes to Section 15E of the Securities Exchange Act of 1934)

Changes to Subsection (c) Accountability for ratings procedures

Review of Internal Processes for Determining Credit Ratings

- The SEC shall review ratings, and the policies, procedures and methodologies of NRSROs to ensure that the NRSRO:
 - has established and documented a system of internal controls, including due diligence for determining ratings;
 - that it follows such systems; and
 - its disclosures are consistent with such system.
- The reviews will be conducted no less than once a year.

Provision of Information to the Commission

- NRSROs must maintain records and make them available to the SEC

Changes to Subsection (d) – Censure, Denial, or Suspension of Registration, Notice, and Hearing

- Clarifies that the SEC has the ability to apply fines if sufficient surveillance is not conducted.
- Allows the SEC to sanction supervisors who fail to reasonably supervise employees of an NRSRO.

Changes to Subsection (h) – Management of Conflicts of Interest

Board of Directors

- Each NRSRO, or its parent entity, must have a Board of Directors with one-third independent directors whose compensation will not be linked to the performance of the NRSRO and whose non-renewable term will not exceed 5 years.

- The independent directors will oversee the development, maintenance and enforcement of processes for determining ratings, addressing conflicts of interest, the effectiveness of the processes, and the compensation and promotion policies of the employees involved in setting ratings.

Compliance Officer

- Expands compliance officer requirements, including requiring the officer to report directly to the Board of Directors. Also, identifies specific aspects of internal control and conflict of interest policies that should be reviewed (i.e. surveillance).
- Prohibits the compliance officer from performing credit ratings, participating in the development of models and methodologies, taking part in marketing or sales functions, or helping to establish compensation levels (other than for employees directly under his supervision).
- Requires the compliance officer to establish procedures for receiving complaints about conflicts of interest, including anonymous complaints by employees, issuers and investors.
- Requires an annual report by the compliance officer, in accordance with SEC guidance.

Organization Policies and Procedures

- Each NRSRO must establish, maintain and enforce written policies and procedures to address, manage and disclose conflicts of interest.

Governance Improvements at Nationally Recognized Statistical Rating Organization

- Requires governance improvements at NRSROs consistent with rulemaking as described immediately below in Commission Rules.

Commission Rules

- Requires the SEC to establish rules with regard to:
 - conflicts of interest arising from how the NRSRO is paid for ratings;
 - conflicts of interest arising from consulting, advisory, or other services;
 - disclosure of business relationships that present conflicts of interest;
 - disclosure of any affiliations of NRSROs with any person that underwrites investment vehicles that are the subject of a credit rating;
 - disclosure of information about the net revenue of the NRSRO attributable to each entity who paid for a credit rating;
 - establishment of performance-based payments for the ratings;
 - disclosure of the fees associated with a rating and the fees associated with any ratings provided to the same obligor or underwriter and their affiliates in the preceding 2 year period; and

- any other regulations as deemed necessary by the SEC.

Look-Back Requirement

- Requires NRSROs to conduct a look-back review when an employee goes to work for an obligor or underwriter to ensure conflicts of interest are addressed. This requires SEC to review such procedures and directs rating actions where applicable.
- Requires the SEC to conduct periodic reviews of NRSRO's code of ethics and conflict of interest procedures and to make them available to the public.
- Reviews are conducted no less frequently than annually.

Changes to Subsection (k) – Statements of Financial Condition

- Removes the requirement that when an NRSRO provides the SEC with financial statements, it does so on a confidential basis, with the exception of certain information whose release would harm the NRSRO, as determined by the SEC.

Changes to Subsection (m) – Rules of Construction (Renamed “Accountability”)

- Replaces the restriction on private right of action with a statement that NRSROs should be equivalent to registered public accounting firms or securities analysts under the Federal securities laws.
- States that credit ratings shall not be deemed forward looking statements for purposes of section 21E, which provides a safe harbor.

Changes to Subsection (p) - NRSRO Regulation

- Requires the SEC to establish an office to coordinate NRSRO regulation.

New Subsection (g) - Transparency of Ratings Performance

- Requires the SEC to write rules to increase the disclosure of information on both initial ratings and subsequent ratings that investors can compare across NRSROs, and ensure the disclosures are clear and informative, cover long-term performance and various asset classes, and are published and made easily accessible.

New Subsection (r) – Credit Ratings Methodologies

- Requires SEC rulemaking to ensure NRSROs use current methodologies that are approved by NRSRO officials, and that changes to such methodologies are applied to current ratings.
- Requires notification to issuers and investors regarding which version of a model was used and when updates are made.
- Requires the SEC to adopt ratings symbols that distinguish among structured products, non structured products, corporate offerings, municipal offerings (and others products as the SEC deems appropriate).

- Requires each NRSRO to establish and maintain ratings based on assessment of risk that investors will not get paid; to clearly define rating symbols; and to apply symbols consistently. These new requirements do not prohibit an NRSRO from using additional factors in ratings.

New Subsection (s) - Transparency of Credit Rating Methodologies and Information Reviewed

- Requires NRSROs, using a form established by the SEC, to provide information to help investors understand the ratings, such as information about assumptions used in developing the ratings; how the NRSRO used servicer and remittance reports for ratings surveillance (where applicable); potential shortcomings of ratings, including what risks the rating does not take into account; information on the reliability and quality of information reviewed for the rating; whether third party due diligence services were used; and the potential volatility of the rating.
- The form will be made public so others can understand the ratings.
- Requires third party firms that provide due diligence to certify their work to ensure thorough review of such data.

Changes to Subsection (t) Prohibited Activities

- Beginning 180 days from the date of enactment of this Act, it shall be unlawful for an NRSRO and its affiliates
 - To provide consulting and advisory services to companies that it also rates; and
 - To perform any credit rating for any security or money market instrument of an issuer which employs a former NRSRO analyst who had worked at the NRSRO in the past one-year period.
 - The SEC would have exemption authority on these prohibitions when necessary or appropriate for the public interest.

Sec. 3. Collective Liability for Credit Ratings.

- Creates a system whereby nationally recognized statistical rating organizations share oversight of the information used by each such organization and share liability for any violation of the securities laws.

Sec. 4. State of Mind in Private Actions

- Amends Section 21D(b)(2) of the Securities Exchange Act of 1934 (which addresses state of mind in securities fraud actions) to clarify the pleading standard for NRSROs under securities fraud actions.
- A plaintiff must plead that a rating agency "knowingly or recklessly" failed to conduct a reasonable investigation or failed to review any due diligence reports it received.

- Clarifies that this scienter standard of “knowingly or recklessly” is the same as would apply to issuers and underwriters, and that this does not change the requirements of the Private Securities Litigation Reform Act of 1995.

Sec. 5. Issuer Disclosure of Preliminary Ratings

- Requires issuers to disclose preliminary credit ratings received from an NRSRO on structured products and all forms of corporate debt.

Sec. 6. Regulations

- Unless otherwise noted, the SEC must issue final rules and regulation for this Act within 365 days of enactment.

Sec. 7. Removal of Statutory References to Credit Ratings

- In an effort to remove the reliance on ratings, this section removes references to ratings in federal statutes where such references are made.
- This shall be effective 6 months after the date of enactment of this Act.

Sec. 8. Federal Agency Review of Reliance on Ratings

- Not later than one year after the date of enactment of this Act, Federal agencies are instructed to review its regulations, policies and practices which reference ratings to determine if another credit measure would be appropriate.
- Federal agencies will report to Congress after the review.

Sec. 9. Studies and Reports

- Not later than 30 months of enactment of this Act, GAO will conduct a study of
 - the implementation of this Act;
 - the appropriateness of relying on ratings in Federal, State and local securities and banking regulations;
 - the effect of liability in private actions arising under the Securities Exchange Act of 1934; and
 - alternative means for compensating credit rating agencies to create incentives for more accurate ratings.

- Within one year of enactment, the SEC will undertake a study on creating a system whereby NRSROs are assigned to issuers seeking a credit rating on a rotating basis.