
**2016 SUMMARY REPORT OF COMMISSION STAFF'S EXAMINATIONS OF
EACH NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION**

As Required by Section 15E(p)(3)(C)
of the Securities Exchange Act of 1934



This is a report of the Staff of the U.S. Securities and Exchange Commission.

**The Commission has expressed no view regarding the analysis, findings, or conclusions
contained herein.**

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I. REGULATORY AND NRSRO OVERVIEW

This report (“Report”) summarizes the examinations conducted by staff from the U.S. Securities and Exchange Commission (the “Staff”) under Section 15E(p)(3) of the Securities Exchange Act of 1934 (“Exchange Act”).¹ This is a report of the Staff and, as such, reflects solely the Staff’s views. The U.S. Securities and Exchange Commission (“Commission” or “SEC”) is making this Staff Report public as required by Section 15E(p)(3)(C) of the Exchange Act.

A. Statutory Framework and Rules

Section 15E of the Exchange Act (“Section 15E”) and Exchange Act Rules 17g-1 through 17g-10 govern the registration and oversight program for credit rating agencies that are registered with the Commission as nationally recognized statistical rating organizations (“NRSROs”). This regulatory regime was established by the Credit Rating Agency Reform Act of 2006 (the “Rating Agency Act”)² and amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”).³

The Dodd-Frank Act mandated the creation of the Office of Credit Ratings (“OCR”), which is responsible for oversight of credit rating agencies registered with the Commission as NRSROs. OCR was established in June 2012 with the appointment of its Director, Thomas J. Butler. The Dodd-Frank Act requires OCR to conduct an examination of each NRSRO at least annually and to make available to the public an annual report summarizing these examinations.⁴

The Dodd-Frank Act directed the Commission to adopt and amend a number of rules related to NRSROs. In August 2014, the Commission adopted new Rules 17g-8, 17g-9, and 17g-10 as well as Form ABS Due Diligence-15E, and amended Rules 17g-1 through 17g-3 and 17g-5 through 17g-7 as well as Form NRSRO.⁵ Most of these new and amended rules became effective on June 15, 2015.

The subjects addressed by these new and amended rules include NRSROs’ internal control structures, rating methodologies and models, rating symbols, conflicts of interest relating to sales and marketing activities, post-employment reviews, disclosure forms and certifications to accompany each credit rating, public disclosures of credit rating performance statistics and credit

¹ 15 U.S.C. § 78o-7(p)(3)(C). Unless otherwise noted, all Section and Rule references in this report are to the Exchange Act and rules under the Exchange Act. *See* 15 U.S.C. § 78o-7; 15 U.S.C. § 78q (a) and (b); 17 CFR 240.17g-1 through 17g-10.

² Credit Rating Agency Reform Act of 2006, Pub. L. No. 109-291, 120 Stat. 1327 (2006).

³ The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 932, 124 Stat. 1376, 1872-83 (2010).

⁴ 15 U.S.C. § 78o-7(p)(3).

⁵ *See* Nationally Recognized Statistical Rating Organizations; Final Rule, Exchange Act Release No. 72936 (Aug. 27, 2014); 79 FR 55078 (Sept. 15, 2014).

rating histories, assessment and reporting by NRSROs' management regarding the effectiveness of their internal control structures, asset-backed securities ("ABS") third-party due diligence providers, and NRSROs' standards of training, experience, and competence.

Pursuant to the Commission's regulatory regime for NRSROs, an NRSRO is required to, among other things:

- File with the Commission annual certifications of its Form NRSRO registrations,⁶ promptly update its filing in certain circumstances,⁷ and make its current Form NRSRO filing and most of its current Form NRSRO Exhibits available on its public website.⁸
- Disclose certain information, including information concerning the NRSRO's performance measurement statistics and its procedures and methodologies to determine ratings.⁹
- Establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings,¹⁰ and retain records of its internal control structure.¹¹
- Consider certain factors with respect to its establishment, maintenance, enforcement, and documentation of an effective internal control structure.¹²
- Establish, maintain, enforce, and document policies and procedures reasonably designed to achieve certain objectives concerning its development and application of, and disclosures related to, methodologies and models.¹³
- File an unaudited report containing an assessment by management of the effectiveness during the fiscal year of the NRSRO's internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for

⁶ 15 U.S.C. § 78o-7(b)(2) and 17 CFR 240.17g-1(f).

⁷ 15 U.S.C. § 78o-7(b)(1) and 17 CFR 240.17g-1(e).

⁸ 15 U.S.C. § 78o-7(a)(3) and 17 CFR 240.17g-1(i).

⁹ 15 U.S.C. § 78o-7(a)(1)(B)(i) and § 78o-7(a)(1)(B)(ii).

¹⁰ 15 U.S.C. § 78o-7(c)(3)(A). Significantly, the regulatory regime expressly prohibits the Commission from regulating the substance of credit ratings. 15 U.S.C. § 78o-7(c)(2).

¹¹ 17 CFR 240.17g-2(b)(12).

¹² *See, e.g.*, 17 CFR 240.17g-8(d)(1) through (4).

¹³ *See, e.g.*, 17 CFR 240.17g-8(a)(2) through (5).

determining credit ratings.¹⁴ The report must be accompanied by a signed statement by the NRSRO's chief executive officer or an individual performing similar functions.¹⁵

- Establish, maintain, enforce, and document policies and procedures that are reasonably designed to: assess the probability that an issuer of a security or money market instrument will default or fail to make required payments to investors,¹⁶ and ensure that it applies any rating symbol, number, or score in a manner that is consistent for all types of obligors, securities, and money market instruments for which the symbol, number, or score is used.¹⁷
- Publish an information disclosure form when taking a rating action with respect to a rating assigned to an obligor, security, or money-market instrument in a class for which it is registered as an NRSRO.¹⁸ The information form must disclose certain information with respect to the particular rating action.¹⁹ In addition, the NRSRO must attach to the information disclosure form a signed statement by a person within the NRSRO with responsibility for the rating action.²⁰

¹⁴ 17 CFR 240.17g-3(a)(7)(i).

¹⁵ 17 CFR 240.17g-3(b)(2).

¹⁶ 17 CFR 240.17g-8(b)(1).

¹⁷ 17 CFR 240.17g-8(b)(3).

¹⁸ 17 CFR 240.17g-7(a). Rule 17g-7(a) defines rating action to include an expected or preliminary rating, an initial rating, an upgrade or downgrade of an existing rating (including a downgrade to, or assignment of, default), and an affirmation or withdrawal of an existing rating if the affirmation or withdrawal is the result of the NRSRO's review of the rating using applicable procedures and methodologies for determining credit ratings. 17 CFR 240.17g-7(a). Pursuant to Rule 17g-7(a)(3), an NRSRO is exempt from publishing an information disclosure form for a particular rating if (i) the rated obligor or issuer of the rated security or money market instrument is not a U.S. person, and (ii) the NRSRO has a reasonable basis to conclude that a security or money market instrument issued by the rated obligor or the issuer will be offered and sold upon issuance, and that any underwriter or arranger linked to the security or money market instrument will effect transactions in the security or money market instrument after issuance, only in transactions that occur outside the United States. 17 CFR 240.17g-7(a)(3).

¹⁹ The information that must be disclosed in the information disclosure form is specified in 17 CFR 240.17g-7(a)(1)(ii)(A) - (N). These required disclosures include: the version of the procedure or methodology used to determine the credit rating; disclosures concerning the uncertainty of the rating, including regarding the reliability, accuracy, quality, and accessibility of data related to the rating; a statement containing an overall assessment of the quality of information available and considered in determining the credit rating for the obligor, security, or money market instrument; and information on the sensitivity of the rating to assumptions made by the NRSRO. In addition, an NRSRO must attach to the information disclosure form any executed Form ABS Due Diligence-15E containing information about the security or money market instrument subject to the rating action that is received by the NRSRO or obtained by the NRSRO through a Rule 17g-5(a)(3) website.

²⁰ 17 CFR 240.17g-7(a)(1)(iii).

- Make and retain, or retain, certain records, including a record documenting its established procedures and methodologies used to determine credit ratings²¹ and records related to its ratings.²² An NRSRO must promptly furnish to the Commission or its representatives copies of required records, including English translations of those records upon request.²³
- Establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material non-public information (“MNPI”), including the inappropriate dissemination of MNPI both within and outside the NRSRO, the inappropriate trading of securities using MNPI by a person within the NRSRO, and the inappropriate dissemination of pending credit rating actions within and outside the NRSRO before issuing the rating on the Internet or through another readily accessible means.²⁴
- Establish, maintain, and enforce written policies and procedures reasonably designed to address and manage conflicts of interest.²⁵ Certain conflicts of interest are expressly prohibited,²⁶ and for other types of conflicts of interest, the NRSRO must disclose the conflict and have policies and procedures in place to manage them.²⁷
- Refrain from engaging in specified unfair, coercive, or abusive practices.²⁸

²¹ 17 CFR 240.17g-2(a)(6).

²² The records that an NRSRO must make and retain, or retain, with respect to its ratings include the identity of certain persons that participated in determining or approving the rating, records used to form the basis of a rating, external and internal communications received or sent by the NRSRO and its employees related to a rating, and for ABS ratings, a record of the rationale for any material difference between the final rating assigned and the rating implied by a quantitative model that was a substantial component in determining the rating. 17 CFR 240.17g-2(a)(2)(i) and (ii), 17 CFR 240.17g-2(b)(2), (b)(7), and (a)(2)(iii).

²³ 15 U.S.C. § 78q (a) and (b) and 17 CFR 240.17g-2(f).

²⁴ 15 U.S.C. § 78o-7(g) and 17 CFR 240.17g-4.

²⁵ 15 U.S.C. § 78o-7(h) and 17 CFR 240.17g-5.

²⁶ 17 CFR 240.17g-5(c).

²⁷ 17 CFR 240.17g-5(a)(1) and (a)(2); 17 CFR 240.17g-5(b). Moreover, Rule 17g-5(a)(3) prohibits NRSROs from having conflicts of interest related to a rating for a security or money market instrument issued by an asset pool or as part of any ABS transaction unless the NRSRO, among other things, maintains and provides access to a password-protected Internet Web site containing a list of each such security or money-market instrument for which it is currently in the process of determining an initial credit rating, and obtains certain written representations from the issuer, sponsor, or underwriter of each such security or money-market instrument.

²⁸ 17 CFR 240.17g-6.

- Provide information on whether it has in effect a code of ethics, and if not, the reasons it does not have a code of ethics.²⁹
- Establish procedures for the receipt retention, and treatment of complaints regarding credit ratings, models, methodologies, and compliance with the securities laws and its policies and procedures developed under this regulatory regime, and of confidential, anonymous complaints.³⁰
- Designate a compliance officer (the “DCO”) responsible for administering policies and procedures related to MNPI and conflicts of interest, ensuring compliance with the securities laws and regulations, and establishing procedures for handling complaints by employees or users of credit ratings.³¹ The DCO must submit an annual report to the NRSRO on the compliance of the NRSRO with the securities laws and the NRSRO’s policies and procedures, and the NRSRO must file the report with the Commission.³²
- Have a board of directors or similar governing body, certain of whose members must be independent from the NRSRO.³³ An NRSRO’s board of directors or governing body, and/or members thereof, are responsible for exercising oversight of specified subjects related to the NRSRO’s rating business, and for approving the procedures and methodologies, including qualitative and quantitative data and models, that the NRSRO uses to determine ratings.³⁴
- Establish, maintain, enforce, and document standards of training, experience, and competence for the individuals it employs to participate in the determination of credit ratings that are reasonably designed to achieve the objective that the NRSRO produces accurate credit ratings, and retain a record of these standards.³⁵
- Establish policies and procedures regarding post-employment activities of certain former personnel.³⁶

²⁹ 15 U.S.C. § 78o-7(a)(1)(B)(v).

³⁰ 15 U.S.C. § 78o-7(j)(3).

³¹ 15 U.S.C. § 78o-7(j)(1) and (3).

³² 15 U.S.C. § 78o-7(j)(5).

³³ 15 U.S.C. § 78o-7(t)(2).

³⁴ 15 U.S.C. § 78o-7(t)(3) and 17 CFR 240.17g-8(a)(1).

³⁵ 17 CFR 240.17g-9.

³⁶ 15 U.S.C. § 78o-7(h)(4) and (5); 17 CFR 240.17g-8(c).

B. Registered NRSROs

In 2007, the Commission began granting registrations to credit rating agencies that applied to be registered as an NRSRO. Credit rating agencies seeking to apply to register with the Commission as an NRSRO may do so by filing a completed Form NRSRO and related Exhibits.³⁷ A credit rating agency may apply to be registered with respect to one or more of the following five classes of credit ratings: (1) financial institutions, brokers, or dealers (“financial institutions”); (2) insurance companies; (3) corporate issuers; (4) issuers of ABS; and (5) issuers of government securities, municipal securities, or securities issued by a foreign government (“government securities”).³⁸

The ten credit rating agencies registered as NRSROs as of December 1, 2016, and dates of their initial registrations are listed below. More information on NRSRO registration applications and the state of competition, transparency, and conflicts of interest among NRSROs is included in the Annual Report to Congress under Section 6 of the Rating Agency Act, available on the Commission’s website: <http://www.sec.gov/ocr>.

NRSRO	Date of Initial Registration
A.M. Best Rating Services (“AMB”) ³⁹	September 24, 2007
DBRS, Inc. (“DBRS”)	September 24, 2007
Egan-Jones Ratings Company (“EJR”)	December 21, 2007
Fitch Ratings, Inc. (“Fitch”)	September 24, 2007
HR Ratings de México, S.A. de C.V. (“HR”)	November 5, 2012
Japan Credit Rating Agency, Ltd. (“JCR”)	September 24, 2007
Kroll Bond Rating Agency, Inc. (“KBRA”) ⁴⁰	February 11, 2008
Moody’s Investors Service, Inc. (“Moody’s”)	September 24, 2007
Morningstar Credit Ratings, LLC (“Morningstar”) ⁴¹	June 23, 2008
S&P Global Ratings (“S&P”) ⁴²	September 24, 2007

For purposes of this Report only, we refer to Fitch, Moody’s, and S&P as larger NRSROs and the seven other NRSROs (AMB, DBRS, EJR, HR, JCR, KBRA, and Morningstar) as smaller NRSROs.

³⁷ 15 U.S.C. § 78o-7(a) and 17 CFR 240.17g-1(a) and (b).

³⁸ 15 U.S.C. § 78(c)(a)(62)(A).

³⁹ Formerly known as A.M. Best Company, Inc.

⁴⁰ Formerly known as LACE Financial Corp.

⁴¹ Formerly known as Realpoint LLC.

⁴² Formerly known as Standard & Poor’s Ratings Services.

II. OFFICE OF CREDIT RATINGS AND EXAMINATION OVERVIEW

A. Examinations under Section 15E(p)(3)

Generally, the purpose of NRSRO examinations is to monitor compliance with federal securities laws and rules, identify conduct or insufficient policies and procedures or ineffective internal controls that potentially violate such laws and rules, and encourage remedial action. To facilitate such remedial action, the Staff sends each NRSRO an exam summary letter that identifies and explains its findings related to that NRSRO and recommends remedial measures. Examinations also serve to inform the Commission and the NRSROs' compliance personnel of regulatory obligations and noteworthy industry developments. If the examination staff identifies potential violations of federal securities laws or rules, the Staff may refer the matter to the Commission's Division of Enforcement ("Enforcement"), which is responsible for further investigation of these potential violations.

Section 15E(p)(3)(B) provides that each NRSRO examination shall include a review of the following eight topic areas ("Section 15E Review Areas"): (i) whether the NRSRO conducts business in accordance with its policies, procedures, and rating methodologies; (ii) the management of conflicts of interest by the NRSRO; (iii) the implementation of ethics policies by the NRSRO; (iv) the internal supervisory controls of the NRSRO; (v) the governance of the NRSRO; (vi) the activities of the DCO of the NRSRO; (vii) the processing of complaints by the NRSRO; and (viii) the policies of the NRSRO governing the post-employment activities of its former personnel.

Section 15E(p)(3)(C) requires the Commission to make publicly available an annual report summarizing: (i) the essential findings of all Section 15E examinations, as deemed appropriate by the Commission; (ii) the NRSROs' responses to any material regulatory deficiencies identified by the Commission; and (iii) whether the NRSROs have appropriately addressed the recommendations of the Commission contained in previous annual reports on examinations.

B. Examination Overview

The 2016 examinations generally focused on the NRSROs' activities for the period covering January 1, 2015 through December 31, 2015 (the "Review Period"). The examinations also reviewed certain activities or credit rating actions from outside the Review Period.

The 2016 examinations reviewed the Section 15E Review Areas and examined each NRSRO's adherence with Section 15E and Rules 17g-1 through 17g-10. Each of the NRSRO examinations was based upon an individualized risk assessment performed by the Staff that determined areas of emphasis and issues of focus for each NRSRO within the Section 15E Review Areas. Thus, the 2016 examinations reviewed each of the Section 15E Review Areas and were tailored to each NRSRO's specific risk profile. The individualized risk assessments took into account a number of factors, including, but not limited to, the NRSRO's rating activities and operations, the Staff's findings, recommendations, and general observations from prior examinations, the impact of a potential or actual internal control or compliance failure by the NRSRO, recent industry developments affecting NRSROs and the asset classes in which the NRSRO is registered, the NRSRO's filings with the Commission and public disclosures, the NRSRO's self-identified

weaknesses, and relevant tips, complaints, and referrals (“TCRs”) received by the Commission. The Staff’s risk assessment also incorporated certain new obligations applicable to NRSROs as a result of the new and amended rules. For example, the Staff’s risk assessment and evaluation of each NRSRO’s internal controls included consideration of a newly required report that NRSRO management must file with the Commission concerning its assessment of the effectiveness of the NRSRO’s internal control structure for determining ratings.

The 2016 examinations also focused on certain subjects and activities that the Staff identified as relevant to several NRSROs, as summarized below.

- New and Amended SEC Rules: As previously mentioned, in August 2014, the Commission adopted new and amended rules concerning NRSROs. Most of these rules became effective on June 15, 2015, which was during the Review Period for the 2016 Section 15E examinations. Thus, the 2016 Section 15E examinations are the first examinations to assess NRSROs’ compliance with these rules.⁴³ Over the course of the 2016 Section 15E examinations, the Staff reviewed whether all of the NRSROs had implemented an effective internal control structure, including policies and procedures, to comply with all of the new and amended rules by the June 15, 2015 effective date. The Staff also reviewed whether all of the NRSROs were complying with these new and amended rules and the NRSROs’ related policies and procedures.
- Information Technology (“IT”): The Staff reviewed all NRSROs’ policies and procedures, controls, resources, and documentation related to IT, with particular focuses on cybersecurity and NRSROs’ social media practices.
- Quantitative Models: The Staff conducted in-depth reviews of certain NRSROs’ policies, procedures, and practices regarding quantitative models used in the rating process. The Staff assessed whether these NRSROs had effective controls, including policies, procedures, and frameworks, for the development, review, testing, validation, and documentation of quantitative models, and whether these NRSROs adhered to such policies, procedures, and frameworks. The Staff also assessed whether these NRSROs applied quantitative models in the rating process in accordance with their policies and procedures, methodologies, and criteria.
- Surveillance of Outstanding Ratings: The Staff reviewed whether certain NRSROs adhered to their policies, procedures, and methodologies related to conducting surveillance of outstanding ratings, including whether they conducted surveillance within their stated timeframes. The Staff also assessed whether these NRSROs committed adequate resources to conduct surveillance timely and completely.

The Staff’s essential findings and recommendations concerning new and amended SEC rules, IT, quantitative models, and surveillance of outstanding ratings are addressed in this Report in the Sections concerning the relevant Section 15E Review Areas.

⁴³ Certain of the new and amended rules became effective in 2014. During the 2015 Section 15E examinations, the Staff reviewed each NRSRO’s compliance with the rules that became effective in 2014 and also assessed each NRSRO’s plans to implement the new and amended rules.

In addition, because many NRSROs operate globally and have one or more credit rating affiliates or regional offices that are located outside the United States and which are included in their NRSRO registrations, the Staff's 2016 examinations included risk-based reviews of the operations and rating activities of certain foreign credit rating affiliates and/or regional offices of some NRSROs. The Staff assessed whether these NRSROs applied rating policies and procedures, methodologies, criteria, and models consistently in their affiliate and regional offices, whether these NRSROs exercised sufficient compliance oversight of their foreign credit rating affiliates and regional offices, and whether these affiliates' and foreign offices' personnel understood the laws applicable to NRSROs, including the new and amended SEC rules. In addition, based on its risk assessment, the Staff reviewed issues or operations specific to these NRSROs and some of their credit rating affiliates or foreign offices. The Staff also reviewed rating files for certain of these NRSROs' ratings that personnel in these foreign offices participated in determining or reviewing. The Staff's findings and recommendations related to these NRSROs' foreign credit rating affiliates or regional offices are addressed in this Report in the Sections concerning the relevant Section 15E Review Areas.

C. The Staff's Findings and Future Expectations Related to the New and Amended SEC Rules

As discussed in the previous Section of this Report, most of the SEC's new and amended rules took effect in 2015, and the 2016 Section 15E examinations were the first examinations to assess NRSROs' compliance with these rules. A significant portion of the Staff's essential findings from the 2016 Section 15E examinations relate to the new and amended SEC rules. The Staff expects that each NRSRO will refine as needed its policies, procedures, and controls related to these rules based on its experiences with the rules to date and the Staff's relevant recommendations from the 2016 Section 15E examinations. Also, over the passage of time, each NRSRO's personnel should develop a better understanding of these rules and the NRSRO's policies, procedures, processes, and controls for implementing these rules. The Staff expects that such developments should enhance each NRSRO's compliance with these rules in the future.

III. SUMMARY OF RESPONSES TO RECOMMENDATIONS FROM PREVIOUS EXAMINATIONS AND NOTABLE IMPROVEMENTS OVER THE COURSE OF THE EXAMINATIONS

A. Responses to Recommendations from Previous Examinations

The Staff's determination that an NRSRO appropriately addressed a recommendation does not constitute its endorsement of that NRSRO or its policies, procedures, internal controls, or operations. In a future examination, the Staff may reevaluate the NRSRO's response to recommendations that it previously deemed to be appropriately addressed by, for example, assessing whether the NRSRO fully implemented remedial measures and whether those remedial measures appear to be effective. The Staff may also review and make recommendations concerning the NRSRO's policies, procedures, internal controls, or operations related to the general subject matter of a recommendation that it previously deemed to be appropriately

addressed. The determination of whether an NRSRO appropriately addressed a recommendation reflects solely the Staff's view and does not necessarily reflect the views of the Commission.

The Staff's assessment of whether an NRSRO has appropriately addressed a recommendation depends on the specific facts and circumstances of each recommendation, including, but not limited to, the promptness of the NRSRO's response, the severity of the conduct at issue, and whether the remedial action undertaken by the NRSRO is expected to fully resolve the Staff's concerns. To assess whether NRSROs appropriately addressed findings from the 2015 examinations, the Staff reviewed each NRSRO's written submission that responded to the Staff's exam summary letter and described its planned remedial measures, and participated in follow-up calls with each NRSRO to discuss its written submission.

During the 2016 Section 15E examinations, the Staff assessed each NRSRO's progress in implementing remedial measures such as drafting policies or procedures or adding resources. In certain instances, the Staff also tested the existence and effectiveness of such measures. In assessing the effectiveness of NRSROs' remedial measures, the Staff is cognizant that NRSROs may not be able to fully implement remedial measures before the Staff commences its Section 15E examinations for the subsequent year, and the Staff may not be able to fully assess the effectiveness of these measures in its Section 15E examinations for that subsequent year.

Based on the Staff's 2016 Section 15E examinations, the Staff has determined that all recommendations from the 2015 exam have now been appropriately addressed.⁴⁴ The NRSROs addressed the 2015 recommendations by taking remedial measures such as adopting new or enhancing existing policies or procedures, enhancing or implementing new internal controls, implementing new systems and processes, and adding personnel and resources.

B. Notable Improvements Over the Course of the Examinations

The Staff's Section 15E examinations over the years have identified certain improvements at one or more of the NRSROs. Generally, NRSRO personnel at all levels of seniority and responsibility have continued to display greater awareness of applicable laws and their obligations as regulated entities. Moreover, the Staff's summary reports covering the Section 15E examinations for the years 2013 through 2015 mention specific improvements by certain NRSROs, and the NRSROs generally have maintained those improvements or built on those improvements by further enhancing the measures undertaken and embedding them in their operations and culture. Examples of improvements that one or more NRSRO implemented in the past and have maintained or enhanced include:

- Implementing software and computer systems intended to increase the automation, efficiency, and capacity of document-retention, monitoring of employees' emails and securities ownership, and other compliance-related tasks.

⁴⁴ As discussed in Section IV.D.3. of this Report, while a smaller NRSRO did not promptly address the Staff's recommendation from the 2015 Section 15E examination concerning its disclosing methodology deviations in its rating publications, this NRSRO did eventually address the recommendation.

- Implementing software and computer systems that are used in the ratings process and intended to reduce the potential for manual error.
- Increased resources and commitment to documenting their operations and retaining such documentation.
- Increasing the number and frequency of audits and other testing conducted to assess the NRSROs' adherence to policies and procedures and compliance with applicable regulations.
- Revising practices regarding performance evaluation, compensation, and promotion to specifically include consideration of an employee's adherence to its rating policies and procedures, code of conduct, and compliance rules.
- Increased awareness of, and commitment of personnel and resources to address, risk-management issues.

In addition, during the 2016 Section 15E examinations, and similar to the Staff's observations from the 2015 examinations, some NRSROs initiated remedial measures soon after the Staff first brought an issue to their attention during the examination rather than initiating responses only after they received the Staff's exam summary letter. These particular NRSROs' enhanced responsiveness to issues raised by the Staff indicates continuing improvement in their compliance cultures and functions.

IV. SUMMARY OF ESSENTIAL FINDINGS

Section 15E(p)(3)(C)(i) requires this Report to contain a summary of the essential findings of the annual examinations, as deemed appropriate by the Commission.

For purposes of this Report, "essential findings" are all findings from the 2016 examinations that were included with one or more recommendations in an exam summary letter sent to an NRSRO. "Essential findings" do not include the Staff's general observations. In this Report, essential findings are organized by the applicable Section 15E Review Areas. This Report uses the phrases "significant," "numerous," "several," and "some" to describe and distinguish the frequency of conduct or instances underlying certain findings. The particular phrase used reflects directionally the number of instances during the Review Period, recognizing that the number of instances may be reflective of a test sample and not necessarily an NRSRO's full activities during the Review Period. The Commission has not determined whether any finding discussed in this Report constitutes a "material regulatory deficiency,"⁴⁵ but may do so in the future.

⁴⁵ 15 U.S.C. § 78o-7(p)(3)(C)(ii).

In the following Sections of this Report, the numbered headers identify in general terms the Staff's findings concerning one or more NRSROs, and the paragraph(s) following each numbered header provide additional detail concerning these findings and the Staff's corresponding recommendations.

A. Review Area: Adherence to Policies, Procedures, and Methodologies

The Staff reviewed rating actions of each NRSRO for certain issuers and obligors to determine whether the NRSRO operated in accordance with its policies, procedures, methodologies, criteria, and models. In addition, the Staff reviewed NRSROs' other ratings-related activities such as the development and application of methodologies, criteria, and models. The Staff also reviewed rating files and documentation of other ratings-related activities to evaluate whether each NRSRO adhered to recordkeeping requirements. To select rating files to review, the Staff used a risk-based sampling process that is consistent with its overall risk assessment approach described in Section II.B of this Report and considered factors including but not limited to the significance of the rated asset class to the financial markets and the NRSRO's business, the NRSRO's activity in the rated asset class, the likelihood of impact on investors if a rating was not determined in accordance with the NRSRO's methodologies and procedures, news reports and developments concerning NRSROs or particular asset classes, TCRs, and information the Staff learned during examinations.

The Staff's essential findings regarding NRSROs conducting ratings-related activities in accordance with their policies, procedures, methodologies, criteria, and models are discussed in this Section of this Report. The Staff's essential findings regarding NRSROs' adherence to policies and procedures related to other Section 15E Review Areas are generally discussed in later Sections of this Report. Instances where policies, procedures, and methodologies need to be established or improved are also generally discussed in later Sections of this Report.

The Staff's essential findings regarding whether each NRSRO has conducted its business in accordance with its policies, procedures and methodologies are as follows:

1. Certain NRSROs did not always properly apply or adhere to their methodologies, criteria, or policies and procedures for determining ratings.

A larger NRSRO's ratings of a certain type of ABS transactions did not adhere to its policies and procedures concerning surveillance and data quality. Specifically, analytical personnel did not review information concerning these securities as frequently as required by this NRSRO's surveillance policies and procedures, which resulted in these ratings not being updated in a timely manner. Moreover, the NRSRO did not review, or sufficiently document its review, of relevant information for a significant number of ratings concerning these ABS. The Staff recommended that the NRSRO ensure it adheres to its policies and procedures and data quality standards for surveillance, affirmation, and withdrawal of its ratings.

A larger NRSRO did not properly apply its methodology when determining or reviewing certain other ABS ratings. Moreover, in contravention of its methodologies and its policies and

procedures concerning ratings and error correction, this NRSRO refrained from taking rating actions concerning these ABS for several months and then initially placed the ratings on negative credit watch rather than downgrading them. Additionally, at a regional office of the NRSRO, certain analysts incorrectly applied the NRSRO's methodology and policies and procedures concerning credit watch and rating publications to some ratings and did not appear to understand the applicable methodology and policies and procedures. The Staff recommended that the NRSRO ensure that its analysts understand and correctly apply its methodologies and policies and procedures for determining ratings, and provide additional training to analysts concerning these subjects. The Staff also recommended that the NRSRO ensure it adheres to its error correction policy, and review whether there is sufficient oversight and controls in its regional offices.

At a larger NRSRO, an analyst used incorrect model inputs when determining certain ABS ratings. After these model input errors were discovered, this larger NRSRO did not inform specified NRSRO personnel of the error as required by its policies and procedures. Moreover, in connection with the initial determination of these ratings and the review of these ratings, the NRSRO did not document the rationale for differences between the ratings implied by the model and the final rating, as required by Rule 17g-2(a)(2)(iii) and its policies and procedures. The Staff recommended that the NRSRO ensure it adheres to Rule 17g-2(a)(2)(iii) and its policies and procedures concerning document retention and model error correction.

In addition, a larger NRSRO's policies and procedures require that models used for credit ratings must be reported to and tracked by the group responsible for model validation, and that temporary use of a model that has not been validated must also be reported and tracked. However, analysts in the NRSRO's ABS group used a model to determine ratings prior to reporting the model to the group responsible for validation, and did not report and track some models that were used in the rating process prior to being validated. The Staff recommended that the NRSRO ensure it adheres to its policies and procedures concerning model version control and model tracking.

A larger NRSRO did not sufficiently document or clearly disclose its application of assumptions that materially deviated from its published methodologies, as required by Rule 17g-2(b)(2) and its policies and procedures, when determining certain ratings of residential mortgage-backed securities ("RMBS"). Also, several RMBS ratings issued by the NRSRO did not document the rationale for deviations between the model-implied rating and the final rating assigned, as required by Rule 17g-2(a)(2)(iii) and its policies and procedures. The Staff recommended that the NRSRO enhance and adhere to its policies and procedures for the documentation and disclosure of material deviations from methodologies, and ensure compliance with Rule 17g-2 and its document retention requirements.

A smaller NRSRO applied incorrect identifiers to several ratings or rated entities, which resulted in errors in this NRSRO's internal records and ratings transition information. The Staff recommended that the NRSRO enhance its internal controls to ensure adherence to its ratings identifiers and other policies and procedures.

2. Certain NRSROs did not make all required disclosures for certain ratings or did not disclose other required ratings-related information.

At a larger NRSRO, the rating publications and/or information disclosure forms for numerous rating actions did not accurately disclose the methodologies applied to determine the ratings, in contravention of its own policies and procedures and Rule 17g-7(a)(1)(ii)(B).

In some instances, a smaller NRSRO did not accurately disclose certain information concerning the criteria applied to determine the rating and the solicited status of ratings, as required by its policies and procedures.

A smaller NRSRO did not publish information disclosure forms for some preliminary credit ratings as required by Rule 17g-7(a), and for one rating action, the Rule 17g-7(a)(1)(iii) attestation was not signed by the rating committee chair as required by its policies and procedures. The NRSRO also did not update ratings-related XBRL information on its website monthly as required by Rule 17g-7(b) and its policies and procedures.

The Staff recommended that these NRSROs ensure they publish complete and accurate disclosures for all applicable ratings as required by Rule 17g-7(a) and their policies and procedures, and also recommended that a smaller NRSRO ensure it discloses credit rating history information with the frequency required by Rule 17g-7(b) and its policies and procedures.

3. In some instances, certain NRSROs did not adhere to their policies and procedures concerning surveillance and/or withdrawals of outstanding ratings.

A smaller NRSRO did not adhere to its policies and procedures concerning ratings surveillance. Two of the NRSRO's ratings remained under review significantly longer than the time period permitted by its procedures. Also at this NRSRO, some ratings remained on this NRSRO's public website for a significant period of time after it ceased conducting surveillance of these ratings. The Staff recommended that the NRSRO enhance and adhere to its policies and procedures concerning ratings surveillance, ratings under review, and discontinued ratings.

A smaller NRSRO withdrew its ratings of some issuers but did not publish rating reports in connection with these withdrawals, as required by its policies and procedures. The Staff recommended that the NRSRO ensure adherence to its policies and procedures for the withdrawal of credit ratings.

A smaller NRSRO did not conduct surveillance reviews of numerous ratings consistently with its public disclosures concerning its surveillance process. The Staff recommended that the NRSRO consider revising its public disclosures to better describe its surveillance practices.

4. In some instances, certain NRSROs did not adhere to applicable laws and/or their policies and procedures when determining or reviewing some rating actions.

At a larger NRSRO, one final rating action was issued without first holding a rating committee meeting concerning a related issuer, as required by its policies and procedures, and some other ratings did not correctly document the applicable criteria as required by Rule 17g-2 and its policies and procedures. Several rating files of a larger NRSRO were missing certain documents, including transaction documents and model-related documents, in contravention of Rule 17g-2(b)(7) and this NRSRO's policies and procedures.

At a smaller NRSRO, several rating files did not contain complete and accurate rating committee minutes, conflict of interest attestations, document checklists, and internal emails concerning the ratings, in contravention of Rules 17g-2(b)(2) and (7) and its policies and procedures. For some ratings issued by a smaller NRSRO, internal documents did not indicate whether these ratings were identified for further review and the rating publications did not explain the difference between the rating implied by the model and the assigned rating and/or did not disclose adjustments to model inputs, as required by its policies and procedures. At a smaller NRSRO, numerous rating files did not contain properly completed conflict of interest certifications or other rating committee records required by its policies and procedures and Rule 17g-2(b).

The Staff recommended that these NRSROs ensure they adhere to applicable laws and policies and procedures concerning determining ratings and make and retain or retain all required documents.

5. In some instances, certain NRSROs did not adhere to their policies and procedures concerning protection of MNPI such as pending ratings and non-public information obtained to determine ratings.

At a larger NRSRO, a pending rating was shared with NRSRO personnel who were not involved in determining the rating and did not need this information to perform their job responsibilities, which is inconsistent with the requirements of Section 15E(g) and Rule 17g-4. A larger NRSRO prematurely published a rating release concerning a pending business transaction by an issuer before the issuer had publicly announced the transaction, in contravention of Section 15E(g) and Rule 17g-4(a)(3). A smaller NRSRO disseminated a new rating prior to providing the issuer with an opportunity to decline the rating, in contravention of its policies and procedures. At a smaller NRSRO, there were several instances where NRSRO employees emailed MNPI concerning the rating business to their personal email accounts, which was prohibited by this NRSRO's policies and procedures.

The Staff recommended that these NRSROs ensure their employees adhere to all requirements of Section 15E(g) and Rule 17g-4 as well as their policies and procedures concerning protection of MNPI.

B. Review Area: Management of Conflicts of Interest

The Staff's essential findings regarding the management of conflicts of interest are as follows:

1. Certain NRSROs' policies and procedures for separating analytical activities from sales and marketing activities and preventing analytical activities from being influenced by sales and marketing considerations did not address all of the conduct prohibited by Rule 17g-5(c)(8). Also, certain NRSROs did not establish, maintain, enforce, or document effective internal controls to ensure that analytical activities are separated from sales and marketing activities and are not influenced by sales and marketing considerations.

At a larger NRSRO, the policies and procedures intended to comply with Rule 17g-5(c)(8) defined sales and marketing activities too narrowly to satisfy the Rule requirements. For example, the NRSRO's policies and procedures did not prohibit analytical personnel from discussing its rating methodologies and ratings for the purpose of soliciting or developing business, nor did they prohibit analysts from engaging in general discussions concerning contracts, pricing, fees, or sales. The Staff recommended that the NRSRO ensure its policies and procedures comply with Rule 17g-5(c)(8).

At a larger NRSRO, a sales and marketing manager attended a meeting that was purely analytical in nature in order to serve as a translator at the meeting. While the NRSRO's policies and procedures generally prohibited such conduct, its policies and procedures authorized its head of ratings to grant an exception to this prohibition and the NRSRO granted such an exception in this instance. However, Rule 17g-5(c)(8) strictly prohibits sales and marketing employees' participation in analytical matters and does not permit an NRSRO to grant exceptions to the prohibited conduct, thus the provision in this NRSRO's policies and procedures allowing it to grant exceptions and this sales and marketing employee's attendance at the analytical meeting did not comply with the requirements of Rule 17g-5(c)(8). The Staff recommended that the NRSRO revise its policies and procedures to ensure they meet the requirements of Rule 17g-5(c)(8) and ensure its personnel adhere to Rule 17g-5(c)(8).

A smaller NRSRO's policies and procedures did not prohibit all of the conduct covered by Rule 17g-5(c)(8) and did not apply to all relevant NRSRO personnel. The NRSRO also did not have effective controls to ensure compliance with Rule 17g-5(c)(8). For example, the NRSRO permitted analytical and sales and marketing personnel to attend joint meetings as long as the analytical personnel leave the meetings when commercial matters are discussed, but it did not monitor or document such joint meetings. A smaller NRSRO's policies and procedures did not require its compliance department to be notified of instances where analytical personnel were exposed to sales and marketing information or commercial personnel were exposed to analytical information. A smaller NRSRO did not have policies and procedures that specifically and completely addressed all of the conduct prohibited by Rule 17g-5(c)(8) and applied to all applicable NRSRO personnel. The Staff recommended that these NRSROs establish, maintain, and enforce written policies and procedures that restrict all activities prohibited by Rule 17g-5(c)(8) and apply to all applicable personnel. The Staff also recommended that one of these NRSROs enhance its controls over meetings that are attended jointly by analytical and sales and marketing personnel, and that another one of these NRSROs enhance its policies and procedures to address instances where analysts are exposed to rating fee information.

A smaller NRSRO permitted sales and marketing personnel to attend meetings with analysts and issuers as long as sales and marketing activities do not occur and confidential ratings information is not discussed at these meetings. However, the NRSRO did not monitor or document such meetings. The Staff recommended that the NRSRO enhance its controls over meetings that are attended jointly by sales and marketing and analytical personnel to ensure compliance with Rule 17g-5(c)(8). In addition, when reviewing the NRSRO's compliance logs, the Staff identified several instances where the NRSRO's sales and marketing personnel or third-parties emailed fee information to the NRSRO's analysts. The Staff recommended that the NRSRO enhance its policies and procedures and controls to ensure that analytical personnel are not exposed to fee information and to address instances where analytical personnel are exposed to fee information.

A smaller NRSRO's policies and procedures permitted analysts to engage in certain conduct that may be inconsistent with Rule 17g-5(c)(8) in some instances. The Staff recommended enhancements to the NRSRO concerning its policies and procedures and controls related to Rule 17g-5(c)(8).

2. The Staff observed weaknesses in certain NRSROs' compliance with the prohibition on advising issuers, obligors, or sponsors concerning assets or their activities that are subject to the NRSRO's rating.

A larger NRSRO had policies and procedures prohibiting analytical personnel from engaging in conduct that is prohibited by Rule 17g-5(c)(5) or could compromise the analyst's objectivity in determining a rating. However, it appeared that a senior analytical manager at the NRSRO communicated orally to an ABS issuer that credit enhancements could be reduced, communicated with ABS issuers concerning subjects other than analytical matters, and mentioned market share considerations in discussions with a junior analyst, in contravention of these policies and procedures. Moreover, the NRSRO's policies and procedures required specific personnel to review the rating and the NRSRO to issue a publication that confirms or revises the rating and discloses the potential violation of the prohibition on advising issuers. In this instance, the NRSRO reviewed the rating and determined there was no impact on the credit enhancement level, but this review was not conducted by the required personnel and the NRSRO did not issue the required publication. The Staff recommended that the NRSRO ensure all of its employees comply with its policies and procedures concerning the prohibition on advising issuers, and that the NRSRO adhere to its policies and procedures concerning remedial measures if its personnel engage in such prohibited conduct.

A larger NRSRO prohibited its personnel from making recommendations to issuers as required by Rule 17g-5(c)(5), but it did not have effective internal controls, including policies and procedures and sufficient documentation, to ensure that analytical personnel did not engage in such prohibited conduct. For example, the NRSRO's analysts communicated initial analysis and feedback to issuers orally and did not sufficiently document the timing or content of such communications, which limited the feasibility of determining whether the analyst improperly made a recommendation. In addition, the NRSRO's policies and procedures and training materials were unclear regarding whether and how the NRSRO's personnel were permitted to provide issuers with initial information concerning credit enhancement. The Staff recommended

that the NRSRO review its policies, procedures, and training materials to ensure they clearly define prohibited conduct regarding advising issuers, and that it maintain effective internal controls and sufficient documentation to comply with the prohibition in Rule 17g-5(c)(5).

3. An NRSRO did not have sufficient policies and procedures and effective internal controls concerning issuing or maintaining ratings of entities that have ownership interests in this NRSRO.

A larger NRSRO did not have a policy and procedure prohibiting it from issuing or maintaining a rating on an entity that has a controlling interest in it. The Staff recommended that the NRSRO establish policies and procedures to address the conflict of interest prohibited by Rule 17g-5(c)(3).

A larger NRSRO acknowledged that its issuing ratings for entities that have ownership interests in its parent company constitutes a conflict of interest. The NRSRO's policies and procedures required it to take certain measures to manage this conflict if it issued or maintained a rating on an entity that has a significant ownership interest in its parent company. However, this policy did not apply to the NRSRO's ratings of subsidiaries or affiliates of an entity that has a significant ownership interest in its parent company. The Staff recommended that the NRSRO ensure that it manages conflicts of interest related to its issuing and maintaining ratings of entities that have significant ownership interests in its parent company and the subsidiaries or affiliates of such entities.

4. There were weaknesses in certain NRSRO's policies, procedures, and internal controls concerning various other conflicts of interest.

A larger NRSRO published research concerning issuers and obligors for which the NRSRO also issued and maintained credit ratings. These research publications often provided context for a credit rating concerning such issuers and obligors, and the NRSRO sometimes considered its research publications when reviewing its ratings of these issuers and obligors. The same analytical personnel generally worked on both ratings and related research concerning particular issuers or obligors. However, the NRSRO's policies, procedures, and controls did not prohibit issuers and obligors from improperly influencing the content of research publications. Moreover, it appeared to the Staff that the NRSRO's sales and marketing personnel suggested the subjects that research publications should cover in order to assist with developing business. The Staff recommended that the NRSRO enhance its internal controls, including policies and procedures, concerning research publications to ensure that they address conflicts of interest covered by Rules 17g-5(b)(1), (2), and (9) related to being paid by issuers, underwriters, obligors, and sponsors.

A larger NRSRO's policies and procedures did not prohibit certain unfair, coercive, or abusive practices as required by Rules 17g-6(a)(1) through (3). The NRSRO's policies and procedures only prohibited it from engaging in the conduct addressed by Rules 17g-6(a)(1) through (3) if done for an anticompetitive purpose, even though anticompetitive purpose is not a requirement

of Rules 17g-6(a)(1) through (3). The Staff recommended that the NRSRO ensure that its policies and procedures fully prohibit the unfair, coercive, or abusive practices as required by Rule 17g-6.

A smaller NRSRO's policies and procedures for handling rated entities' comments concerning draft rating publications did not effectively ensure that rated entities did not improperly influence the content of its ratings or ratings publications. The Staff recommended that the NRSRO enhance its policies, procedures, and internal controls to ensure effective management of the conflicts of interest covered by Rules 17g-5(b)(1) and (2) related to being paid by issuers, underwriters, obligors, and sponsors.

A smaller NRSRO posted on its social media account non-ratings publications that were written by an entity related to this NRSRO. Such postings were inconsistent with the NRSRO's policies and procedures requiring separation of ratings and non-ratings activities and with Rule 17g-5(b)(3), which requires an NRSRO to disclose, address, and manage the conflict of being paid for services in addition to determining ratings by issuers, underwriters, or obligors that have paid the NRSRO to determine a rating. The Staff recommended that the NRSRO enhance its internal controls, including policies and procedures, to manage the conflict related to its social media accounts and providing services in addition to ratings.

A smaller NRSRO did not have written policies and procedures governing its periodic reviews of employees' securities holdings, and did not accurately document and internally report on such reviews. The Staff recommended that the NRSRO consider enhancing its documentation of and reporting on its securities monitoring activities.

At a smaller NRSRO, the seating arrangements at one of its regional offices did not separate analytical personnel from different groups, which resulted in analytical personnel having access to information that was not related to their analytical responsibilities and increased the risk that they could engage in securities transactions using MNPI related to issuers this NRSRO rates. The Staff recommended that the NRSRO ensure its office seating arrangements are consistent with its analysts' responsibilities and policies and procedures concerning securities ownership and MNPI.

C. Review Area: Implementation of Ethics Policies

Each NRSRO has implemented written ethics policies and procedures. During the 2016 examinations, the Staff reviewed each NRSRO's ethics policies and procedures, as well as a sample of each NRSRO's employee certifications or monitoring activities concerning its code of ethics. Much of the content of these policies and procedures addresses other related Review Areas. As such, the Staff's findings and recommendations related to an NRSRO's implemented ethics policies and procedures are addressed in other Sections of this Report.

D. Review Area: Internal Supervisory Controls

The Staff reviewed each NRSRO's overall control structure, including the internal control structure related to determining credit ratings.

The Staff's essential findings regarding internal supervisory controls are as follows:

1. At certain NRSROs, policies and procedures concerning the rating process did not meet all legal requirements or had other weaknesses.

There were weaknesses in a larger NRSRO's internal controls for dependent ratings, including internal systems that reflect dependencies between ratings or issuers and the processes for ensuring that dependent ratings were changed promptly when there was a change to a related rating or issuer. The Staff recommended that the NRSRO enhance its internal controls to ensure that dependent ratings are reviewed in a timely manner and that rating changes for dependent ratings are published in a timely manner.

A smaller NRSRO did not have effective controls to ensure that rating committee materials explain criteria deviations and differences between the model-implied rating and the final rating. The NRSRO also did not have policies and procedures to ensure the review of information received and used in the rating process for completeness, quality, and reliability, or to disclose this information as required by Rules 17g-7(a)(1)(ii)(E) and (I). The Staff recommended that the NRSRO ensure that its rating committee materials consistently explain criteria and model deviations, and that it establish, maintain, enforce, and document policies, procedures, and internal controls to evaluate and make required disclosures related to data and information used in the ratings process.

A larger NRSRO and a smaller NRSRO did not have policies and procedures reasonably designed to ensure that they consistently apply their rating symbol, number, or score, as required by Rule 17g-8(b)(3). In addition, the smaller NRSRO did not have policies and procedures reasonably designed to determine the probability of default, as required by Rule 17g-8(b)(1). There were also discrepancies between the smaller NRSRO's ratings definitions and default probability tables. The Staff recommended that the NRSROs establish, maintain, enforce, and document policies and procedures to comply with Rule 17g-8(b)(3). The Staff further recommended that the smaller NRSRO review its default probabilities and revise any discrepancies, and that it establish, maintain, enforce, and document policies and procedures reasonably designed to assess the probability of default as required by Rule 17g-8(b)(1).

A smaller NRSRO did not appear to consider the factors concerning its internal control structure that are required to be considered by Rule 17g-8(d). The Staff recommended that the NRSRO ensure it considers the internal control factors specified in Rule 17g-8(d) and sufficiently documents its consideration of these factors.

A smaller NRSRO did not sufficiently document its internal control structure. The NRSRO did not have sufficient policies and procedures concerning its consideration of the factors required by Rule 17g-8(d) concerning its internal control structure, nor did it document its consideration

of these factors. The NRSRO also did not document its procedure for converting private ratings into public ratings, and its document retention policies and procedures did not comply with all the requirements of Rules 17g-2(a), (b), and (c). The Staff recommended that the NRSRO enhance its policies, procedures, and documentation regarding its consideration of the factors required by Rule 17g-8(d). The Staff also recommended that the NRSRO establish, maintain, enforce, and document policies and procedures concerning conversion of a private rating into a public rating as well as policies and procedures concerning document retention that satisfy the requirements of Rule 17g-2(a) through (c).

At a smaller NRSRO, there were weaknesses in some policies and procedures concerning the rating process. Some of the NRSRO's policies and procedures were not timely updated to reflect its ratings operations and applicable laws, and other policies and procedures were not internally consistent or referenced other policies that were no longer in effect. The Staff recommended that the NRSRO improve its internal controls related to revising policies and procedures governing the rating process in order to facilitate compliance with Section 15E(c)(3)(A).

A smaller NRSRO's policies and procedures did not clearly and consistently define the personnel and roles that were responsible for determining and reviewing ratings, which posed the risk that unauthorized personnel could participate in a rating committee or other rating activities. The NRSRO also did not have policies and procedures concerning the requirement in Section 15E(u) to report to law enforcement authorities material information concerning securities law violations by a rated entity. The Staff recommended that the NRSRO revise its policies and procedures to address these weaknesses.

2. Certain NRSROs did not have effective policies and procedures or internal controls concerning the development, documentation, or application of methodologies, criteria, or models.

A larger NRSRO's policies and procedures concerning model development did not comprehensively describe the process or identify the responsible personnel for approving quantitative models before their use in the rating process. The NRSRO also did not have effective internal controls, including policies and procedures, to manage the risk of model input errors. The Staff observed that a significant number of the NRSRO's potential or actual analytical errors resulted from incorrect model inputs. The Staff recommended that the NRSRO establish, maintain, enforce, and document an effective internal control structure consistent with Section 15E(c)(3)(A), including policies and procedures, concerning the approval of model changes and the review and documentation of model inputs.

A larger NRSRO's criteria validation policies, procedures, and processes did not require it to consider whether criteria assumptions should be updated to reflect more timely data underlying these assumptions. In addition, the NRSRO's assessment of the materiality of model updates did not consider the cumulative impact of model updates. The NRSRO also did not comprehensively log or track potential model errors. The Staff recommended that the NRSRO establish, maintain, enforce, and document an effective internal control structure consistent with Section 15E(c)(3)(A), including policies and procedures, for considering the timeliness of data

when conducting criteria validation, assessing the materiality of model updates, and tracking model errors.

A smaller NRSRO did not have policies and procedures required by Rule 17g-8(a)(3) to ensure that it consistently applies material changes to procedures and methodologies that it uses to determine ratings. The NRSRO also did not have policies and procedures required by Rule 17g-8(a)(4) to ensure that it promptly publishes information concerning material changes to or the existence of errors in the procedures and methodologies, including models and data inputs, that it uses to determine ratings. Moreover, the NRSRO did not have a system for model version control. The Staff recommended that the NRSRO establish, maintain, enforce, and document policies and procedures for compliance with Rules 17g-8(a)(3) and (4) and model version control.

A smaller NRSRO did not have effective policies and procedures for documenting models and did not have a system for model version control, thus its policies and procedures were not reasonably designed to ensure that its models are developed and modified consistently with its policies and procedures and that changes to its models are applied consistently, as required by Rule 17g-8(a)(2) and (3). The NRSRO also did not require documentation of its reviews of transaction-specific cash-flow models to confirm the models reflected the terms of the transaction being rated and to ensure the documentation of the rationale for differences between the ratings implied by the model and the final rating as required by Rule 17g-2(a)(2)(iii). The Staff recommended that the NRSRO establish, maintain, enforce, and document effective internal controls, including policies and procedures, for model documentation and version-control and for the review of transaction-specific cash-flow models.

A smaller NRSRO did not have effective policies, procedures, and internal controls for granting exceptions to its published methodologies and for assigning a final rating that differs from the rating implied by the model. The NRSRO also did not have policies, procedures, and controls for internally tracking and publicly disclosing such exceptions or differences between the model-implied rating and the rating assigned. The Staff recommended that the NRSRO establish, maintain, enforce, and document policies and procedures concerning exceptions to published methodologies and assignment of a final rating that differs from the model-implied rating, including documenting the rationale for differences between the ratings implied by the model and the final rating as required by Rule 17g-2(a)(2)(iii).

3. There were weaknesses in certain NRSROs' policies, procedures, or internal controls to ensure that rating publications contained complete, accurate, and timely information concerning the particular rating actions or the methodologies and criteria applied to those rating actions.

A smaller NRSRO did not promptly and transparently address the Staff's recommendation from the 2015 Section 15E examination concerning its disclosure in rating publications of methodology deviations. Throughout the course of the 2016 Section 15E exam, the NRSRO provided the Staff with vague information concerning the status of its response to this recommendation. Moreover, the NRSRO took almost one year from receipt of the Staff's recommendation from the 2015 Section 15E exam to finalize a procedure for disclosing

methodology deviations. The Staff recommended that the NRSRO must ensure that it addresses all of the Staff's recommendations in a timely manner, and separately from this recommendation, the Staff specifically conveyed to this NRSRO's senior personnel its concerns regarding this untimely response.

A smaller NRSRO did not have effective internal controls to ensure that the information disclosure forms that it published pursuant to Rule 17g-7(a) were complete and accurate for rating publications that contain ratings of several issuers or securities. The Staff recommended that the NRSRO ensure that it publishes complete and accurate information disclosure forms for all rating publications, including for rating publications that concern several rating actions.

A larger NRSRO did not have effective policies, procedures, and internal controls to ensure that its disclosures concerning methodology application and rating errors were complete, accurate, and transparent. The NRSRO's methodology for certain RMBS surveillance ratings did not clearly explain the circumstances when a certain analytical approach is applied, nor did rating publications clearly explain this analytical approach was applied. Moreover, the NRSRO used a publication template for ratings changes resulting from model errors; this publication template, and the rating publications that were based on this template, included a statement that the securities' performance contributed to the rating change, even if the model error was the key driver for the rating change. The Staff recommended that the NRSRO ensure it makes clear disclosures concerning the analytical approaches it takes when applying its methodology, and that it establish, maintain, enforce, and document effective internal controls consistent with Section 15E(c)(3)(A), including policies and procedures, to ensure its rating publications are transparent and detailed.

A larger NRSRO did not have effective policies, procedures, and controls to disclose certain information in its information disclosure forms as required by Rule 17g-7(a). The NRSRO attempted to comply with Rule 17g-7(a)(1)(ii)(M) by developing one distinct set of sensitivity disclosures for each of its ratings business lines. However, the NRSRO's assumptions and sensitivity disclosures were not specific to the particular rating actions; rather, all ratings in a particular asset class would have nearly identical sensitivity disclosures notwithstanding the variety of assumptions and factors that could be applicable within an asset class. The Staff recommended that the NRSRO ensure its disclosures concerning assumptions and sensitivity are specific to the particular rating as required by Rule 17g-7(a)(1)(ii)(M).

A larger NRSRO did not have effective policies, procedures, and internal controls related to Rule 17g-7(a)(3), which exempts NRSROs from publishing an information disclosure form in certain specified circumstances where the NRSRO has a reasonable basis to conclude that the rated security or money-market instrument will only be offered and sold outside of the United States. For example, the NRSRO appeared to rely entirely on a statement by the issuer or underwriter concerning the applicability of this exemption and did not have any process for determining or documenting the reasonableness of its reliance on the issuer's or underwriter's statement. The Staff recommended that the NRSRO enhance its internal controls, including policies and procedures, to ensure its utilization of the exemption is consistent with the parameters of Rule 17g-7(a)(3).

A smaller NRSRO's policies and procedures did not provide a timeframe for publishing a press release concerning a preliminary rating. The Staff recommended that the NRSRO consider revising its policies and procedures to include a timeframe for publishing such press releases.

A smaller NRSRO did not have policies and procedures for disclosing the version of the rating procedure or methodology used for a particular rating as required by Rule 17g-8(a)(5). The Staff recommended that the NRSRO enhance its policies and procedures to address the requirements of Rule 17g-8(a)(5).

A smaller NRSRO did not have policies and procedures required by Rule 17g-8(a)(5) for disclosing the version of the procedure or methodology applied to a particular rating, and numerous information disclosure forms published by the NRSRO did not disclose the proper version of the methodology applied to those ratings as required by Rule 17g-7(a)(1)(ii)(B). The Staff recommended that the NRSRO establish, maintain, enforce, and document policies and procedures for disclosing the version of the procedure or methodology applied as required by Rule 17g-8(a)(5), and internal controls to make the disclosures concerning the version of the procedure or methodology applied as required by Rule 17g-7(a)(1)(ii)(B).

A smaller NRSRO did not have effective internal controls to ensure that rating information is disseminated in a compatible and useable format, which resulted in a third-party publishing some of these NRSRO's ratings inaccurately. The Staff recommended that the NRSRO establish, maintain, enforce, and document effective internal controls consistent with Section 15E(c)(3)(A), including policies and procedures, to prevent the publication of erroneous ratings.

A smaller NRSRO did not publish information disclosure forms for any ratings for several months as a result of its incorrect reliance on the Rule 17g-7(a)(3) exemption. Also, the NRSRO sometimes issued a rating and a summary rating release simultaneously, and published a complete rating release a few days later. However, the NRSRO did not disclose this practice. Moreover, even after the NRSRO began publishing information disclosure forms, it did not publish the information disclosure form at the same time it issued the rating; rather it published the information disclosure form a few days later when the complete rating release was published. The Staff recommended that the NRSRO ensure it publishes information disclosure forms consistently with the requirements of Rule 17g-7(a) for all ratings, and that it consider enhancing its disclosures regarding its rating publication practice.

A smaller NRSRO's policies and procedures only required its information disclosure form to disclose the name of the applicable methodology applied to the rating and not the version of the procedure or methodology applied, in contravention of Rule 17g-8(a)(5). Moreover, the information disclosure forms published by the NRSRO did not include the version of the methodologies applied to the ratings, as required by Rule 17g-7(a)(1)(ii)(B). The Staff recommended that the NRSRO establish, maintain, enforce and document policies and procedures to disclose the version of the procedure or methodology applied pursuant to Rules 17g-8(a)(5) and 17g-7(a)(1)(ii)(B).

A larger NRSRO's policies and procedures did not require it to publish an information disclosure form for rating withdrawals. The Staff recommended that the NRSRO revise its policies and

procedures to require publication of the information disclosure form for all types of ratings subject to Rule 17g-7(a)(1).

A larger NRSRO's policies and procedures did not require it to publish information disclosure forms for some ratings as required by Rule 17g-7(a). The Staff recommended that the NRSRO revise its policies and procedures to require publication of the information disclosure form for all types of ratings subject to Rule 17g-7(a)(1).

A smaller NRSRO did not have policies, procedures, and internal controls that specifically addressed certain requirements of Rule 17g-7(a), including that it have a reasonable basis to rely on the exemption in Rule 17g-7(a)(3). Moreover, the Staff observed one instance where the NRSRO did not publish an information disclosure form for one rating action as required by Rule 17g-7(a). The Staff recommended that the NRSRO ensure it complies with Rule 17g-7(a).

4. There were weaknesses in certain NRSROs' policies, procedures, and controls regarding IT, cybersecurity, or access controls.

At a larger NRSRO, there were weaknesses in controls over the change management process. These weaknesses, which consisted of a process failure and a misinterpretation of business requirements concerning a system change, resulted in incidents where changes or updates to this NRSRO's IT system caused improper delays in publishing required disclosures for a significant number of rating actions or improper withdrawals of a significant number of ratings. The Staff recommended that the NRSRO implement measures to assist analytical and IT personnel with developing system changes and consider implementing quality assurance measures to identify problems related to IT system changes.

A larger NRSRO's policies and procedures contained inconsistent timeframes for remediation of vulnerabilities, and personnel did not always follow the process for exceptions to vulnerability remediation policies and procedures. The Staff recommended that the NRSRO ensure that it establishes and adheres to consistent vulnerability management policies, procedures, and controls.

A larger NRSRO did not have effective internal controls over vulnerability management. The NRSRO did not conduct ongoing vulnerability scans for all of its IT applications and systems that contain MNPI, which could make this NRSRO vulnerable to inadvertent disclosure of MNPI or system disruption, and the NRSRO's policies and procedures concerning certain vulnerability testing contained inconsistent timelines for remediation. The Staff recommended that the NRSRO ensure its policies and standards for vulnerability management are internally consistent, and consider expanding its scope of periodic vulnerability scanning to include all IT systems used in the rating process.

A larger NRSRO's policies and procedures did not provide a specific timeframe for changing IT access rights when an employee changes jobs or roles at the NRSRO. The Staff found one analyst at the NRSRO who, several months after being transferred to a new role, still had access to files of his former rating group that he did not need for his current role. The Staff recommended that the NRSRO consider enhancing its IT system access policies and procedures

to ensure that changes are processed on a timely basis and NRSRO personnel's access is appropriate.

A smaller NRSRO did not have procedures for creating or terminating user accounts for its IT systems or for reviewing access rights to such IT systems, and the Staff identified some instances where email accounts of former NRSRO employees remained active after they ceased employment with the NRSRO. In addition, the NRSRO's policies did not specifically address use by one NRSRO employee of another NRSRO employee's computer or email account, and the Staff identified one instance where an employee of the NRSRO sent a message from another employee's email account. The Staff recommended that the NRSRO consider establishing, maintaining, enforcing, and documenting effective internal controls, including policies and procedures, that address access controls for all IT systems and prevent an employee's use of other employees' IT accounts. The Staff also recommended that the NRSRO conduct a review to ensure that former employees' email accounts have been terminated and are no longer in use.

A larger NRSRO did not sufficiently document its cybersecurity controls and processes, such as the frequency for conducting vulnerability scans, remediation timelines, tracking and reporting requirements, exception handling, and testing plans. The Staff recommended that the NRSRO enhance its policies and procedures to fully document its cybersecurity internal control requirements.

5. Certain NRSROs' Form NRSRO filings and/or internal control reports contained incorrect information, were missing required information, or were not sufficiently detailed.

There were numerous insufficiencies in a smaller NRSRO's filings with the Commission. As examples, the NRSRO's filings did not provide information concerning its rating scales and its procedures and methodologies as required by Sections 15E(a)(1)(B)(i) and (ii) and the Form NRSRO Instructions, did not follow some other requirements of the Form NRSRO Instructions, did not accurately report its 20 largest clients as required by Section 15E(a)(1)(B)(viii), and did not file the certification that must accompany its audited financial statements. Moreover, the NRSRO also did not file its annual financial reports and other reports required by Rule 17g-3 within the timeframe required by Rule 17g-1(f). Also, the NRSRO's report concerning management's assessment of its internal controls did not address the requirements of Rule 17g-3(a)(7)(i)(B) concerning the effectiveness of its internal control structure, and the CEO statement accompanying this report did not satisfy the requirements of Rule 17g-3(b)(2). The Staff recommended that the NRSRO establish, maintain, enforce, and document effective internal controls, including policies and procedures, to ensure its filings with the Commission and related certifications are accurate, timely, and consistent with applicable legal requirements.

The Rule 17g-3 reports concerning management's assessment of internal controls filed by a larger NRSRO and a smaller NRSRO were not sufficiently detailed. These reports reiterated language in Rule 17g-3 concerning management's responsibility and internal controls generally, but did not provide sufficient detail concerning the NRSROs' specific internal controls that govern the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings. Nor did the reports state whether these NRSROs identified any material weaknesses or deficiencies, and if so how they were addressed. The Staff recommended

that these NRSROs ensure that their internal controls reports describe in sufficient detail management's responsibility in establishing and maintaining an effective internal control structure and the effectiveness of its internal controls. In addition, the larger NRSRO's Rule 17g-3 reports were not filed in accordance with the SEC's procedural requirements concerning EDGAR filings. The Staff recommended that the larger NRSRO ensure it adheres to all Commission requirements regarding submission of Rule 17g-3 reports.

A smaller NRSRO's Rule 17g-3 report concerning management's assessment of internal controls did not address certain personnel's role in establishing, implementing, and enforcing the internal control structure, even though the NRSRO stated elsewhere that these personnel had such a role. In addition, the NRSRO did not have policies and procedures concerning management's evaluation of the internal control structure, which ultimately formed the basis of its management certification concerning its internal control structure. There were also insufficiencies in the NRSRO's Form NRSRO filing. As examples, certifications submitted in connection with its annual certification and certain reports were not signed as required by applicable laws, Form NRSRO Exhibits were not consistent with the Form NRSRO Instructions, and the annual certification was submitted after the deadline established by Section 15E(b)(2) and Rule 17g-1(f). The Staff recommended that the NRSRO comply with all applicable regulations when filing documents with the Commission.

A smaller NRSRO did not properly submit certain updated Form NRSRO Exhibits and did not post these Exhibits to its website within 10 business days as required by Rule 17g-1(i). The NRSRO also did not file its 17g-3 reports consistently with applicable laws. Moreover, the NRSRO's Exhibit 2 filing did not provide sufficient information concerning its quantitative and qualitative models, metrics used to determine ratings, or information concerning whether changes to models and criteria are applied retroactively to existing ratings, or the location on its website where such information could be found. The Staff recommended that the NRSRO adhere to applicable legal requirements for filing Form NRSRO and Exhibits and establish procedures to ensure its Form NRSRO filings comply with all applicable rules.

A smaller NRSRO did not file its annual Form NRSRO certification and internal controls report and attestation within the time period required by Section 15E(b)(2) and Rules 17g-1(f) and 17g-3(a), and it did not provide in Exhibit 1 certain information required by the Form NRSRO Instructions. The Staff recommended that the NRSRO ensure that its Form NRSRO filings and internal control reports are filed timely and in accordance with applicable legal requirements.

6. Certain NRSROs did not have effective internal controls to ensure appropriate and independent oversight over the rating process and/or the review and development of methodologies, criteria, and models.

A smaller NRSRO's policies and procedures permitted a rating group senior manager to serve as both secondary analyst and rating committee chair when determining or reviewing a rating. In addition, the NRSRO permitted rating group senior managers to oversee the group that develops methodologies and criteria while also serving as voting members on the committees that approve new and revised methodologies and criteria. Moreover, the NRSRO's senior credit officer was

responsible for supervising a group that was supposed to independently review criteria and methodologies and also was permitted to vote on the committees that initially approve methodologies and criteria. Such practices can result in personnel reviewing their own work rather than such work being reviewed separately by independent personnel. The Staff recommended that the NRSRO establish, maintain, enforce, and document internal controls reasonably designed to ensure that analytical and criteria development tasks are subject to appropriate and independent review.

At a smaller NRSRO, rating releases for several issuers contained language that an analyst copied from external sources and did not independently analyze. The NRSRO's policies and procedures did not expressly prohibit such conduct by the analyst. The NRSRO's investigation of this matter concluded that the language at issue was not likely to affect readers' understanding of the rating publications, and also suggested that the analyst engaged in such conduct due to an overly heavy workload. For some issuers whose rating publications were affected by this conduct, the NRSRO promptly published revised rating releases that removed the improper language, but for other issuers, it only issued updated rating releases in accordance with its regular surveillance procedures and timeline. The NRSRO's rating publications policies were vague and provided the NRSRO with ample discretion concerning whether to issue an updated rating release, which appears to have contributed to its differing approaches for publishing revised rating publications. The Staff recommended that the NRSRO ensure that its staffing practices provide analysts with sufficient time and resources to produce ratings with integrity. The Staff also recommended that the NRSRO revise its policies and procedures to require that ratings work product is based on its personnel's own work, and revise its policies concerning rating publications to provide more clarity and specificity concerning updating rating releases.

At a smaller NRSRO, one senior officer served as a voting member of the group that is responsible for approving the NRSRO's methodologies and models and was also responsible for auditing the effectiveness and quality of the NRSRO's methodologies and models. Such practices resulted in this individual checking his/her own work and did not constitute independent oversight of the process for developing and approving methodologies and models. In addition, this senior officer did not have any dedicated staff to assist with completing these tasks. The Staff recommended that the NRSRO enhance the independence of its functions responsible for the development, approval, and audit of rating methodologies and models, and that it assess whether these functions have adequate staffing and resources and take any appropriate action in light of its assessment.

7. Certain NRSROs had some weaknesses in their standards or internal controls concerning training, experience, and competence.

A smaller NRSRO had not established the required program for analytical training and testing by the effective date of Rule 17g-9. A smaller NRSRO did not sufficiently document its schedules for analytical training and testing. Also, the training that this NRSRO conducted or planned to conduct in a particular year only addressed some but not all asset classes in which this NRSRO is registered. A smaller NRSRO's standards concerning training, experience, and competence did not require periodic testing. Moreover, all of these NRSROs' training, experience, and competence standards did not explicitly mandate that at least one individual involved in

determining a rating have at least three years of experience performing credit analysis, as required by Rule 17g-9(c). The Staff recommended that the NRSROs ensure that their analytical training, competence, and testing standards satisfy the requirements of Rule 17g-9(c) and are sufficiently documented.

A larger NRSRO did not have effective internal controls to ensure all of its personnel complete training concerning its policies and procedures in a timely manner, and the Staff observed some instances where the NRSRO's employees did not receive timely training concerning its policies and procedures. The Staff recommended that the NRSRO enhance its internal controls regarding training.

8. There were weaknesses in policies, procedures, or controls related to prevention of the misuse of MNPI at certain NRSROs.

At a larger NRSRO, certain pending ratings were disseminated on its restricted access websites shortly before they were posted on its public NRSRO website. Because pending ratings constitute MNPI until their publication by the NRSRO, this resulted in selective disclosure of MNPI to certain parties in contravention of Section 15E(g) and Rule 17g-4(a)(3). These selective disseminations appeared to result from the NRSRO not having a process to check that ratings information had been posted to its public website before it was published on restricted access sites.

A smaller NRSRO shared a pending rating of an issuer with an unrelated third-party that solicited this NRSRO's rating of certain bonds issued by that issuer. This pending rating of the issuer was MNPI, and should not have been shared with the third-party prior to the rating being finalized and published. At another smaller NRSRO, policies and procedures prohibiting NRSRO personnel from purchasing, selling, or otherwise benefitting from MNPI did not explicitly apply to money-market instruments, as required by Rule 17g-4(a)(2).

The Staff recommended that these NRSROs ensure they have policies and procedures and effective controls to protect MNPI as required by Section 15E(g) and Rule 17g-4.

9. Certain NRSROs' public disclosures and internal controls related to non-NRSRO rating affiliates were insufficient.

An affiliate of a larger NRSRO that was not registered as an NRSRO issued numerous ratings, and its rating publications did not disclose that this affiliate was not part of the NRSRO and that its ratings were not NRSRO ratings. Moreover, the NRSRO's website also did not sufficiently disclose that this affiliate was not part of the NRSRO.

A smaller NRSRO did not sufficiently disclose on its website or in its rating publications that one of its affiliates was not registered as an NRSRO. The NRSRO also utilized non-NRSRO personnel to assist in determining numerous NRSRO ratings. However, such non-NRSRO personnel were not subject to the NRSRO's policies and procedures requiring attestations that

ratings were not influenced by conflicts of interest, even if such personnel participated in determining NRSRO ratings. Moreover, the NRSRO did not disclose in its Form NRSRO filings or in rating publications that non-NRSRO personnel may participate in determining NRSRO ratings.

The Staff recommended that these NRSROs ensure they sufficiently disclose that ratings issued by their non-NRSRO affiliates are not NRSRO ratings. The Staff also recommended that the smaller NRSRO ensure that it makes adequate disclosures, and maintains effective internal controls consistent with Section 15E(c)(3)(A), concerning non-NRSRO personnel's involvement in determining NRSRO ratings.

10. Certain NRSROs did not have policies and procedures and internal controls to obtain required representations and make required disclosures when determining or issuing ratings of ABS.

A smaller NRSRO did not have policies, procedures, or controls for determining whether a particular transaction constitutes a security or money-market instrument to which the requirements of Rules 17g-5(a)(3) and 17g-7(a)(2) apply. Rather, the NRSRO allowed the issuer to decide whether Rule 17g-5(a)(3) applies, and analytical personnel working on a particular transaction decided for themselves whether the 17g-7(a)(2) provisions apply. The Staff observed one rating by the NRSRO where it did not take the measures required by Rules 17g-5(a)(3) and 17g-7(a)(2) even though this rating related to transactions that appeared to be subject to these Rules. In addition, the NRSRO indicated that it asks the issuer, underwriter, or sponsor to provide the Form ABS Due Diligence-15E, but did not obtain a representation from the issuer, underwriter, or sponsor as required by Rule 17g-5(a)(3)(iii)(E). The Staff recommended that the NRSRO enhance its policies and procedures to ensure it fully complies with Rules 17g-5(a)(3) and 17g-7(a)(2), including that it obtains the required representations related to third-party due diligence services from issuers, sponsors, and underwriters.

A smaller NRSRO did not publish Form ABS Due Diligence-15E in connection with a rating action that the Staff selected for rating file review. The NRSRO acknowledged receiving the third-party due-diligence report, but did not publish it in connection with the rating because it did not use this report in determining its rating. However, Rule 17g-7(a)(2) requires an NRSRO to publish a third-party due diligence report if it receives such a report, regardless of whether or not it considers this report when determining the rating. In addition, the Staff observed that several other Rule 17g-7 disclosures published by the NRSRO state that no third-party due diligence report was used, even though Rule 17g-7(a)(2) requires an NRSRO to publish a Form ABS Due-Diligence 15E if it receives the Form directly or obtains the Form through a Rule 17g-5(a)(3) website, regardless of whether the NRSRO used the Form when taking the rating action. The Staff recommended that the NRSRO establish, maintain, enforce, and document effective internal controls, including policies and procedures, to ensure full compliance with rule 17g-7(a)(2).

E. Review Area: Governance

During the 2016 examinations, the Staff interviewed each NRSRO's board of directors or governing body (hereinafter, collectively the "Board" or "Boards"), including independent directors. The Staff also reviewed minutes and other documentation related to the activities of each NRSRO's Board.

The Staff's essential findings relating to the NRSROs' corporate governance and compliance with Section 15E(t) and Rule 17g-8(a)(1) are as follows:

1. Certain NRSROs' Boards did not approve all methodologies, procedures, and models used to determine ratings as required by Rule 17g-8(a)(1), or did not sufficiently document such approval.

At a larger NRSRO, the Board did not approve all methodologies, procedures, and models used to determine ratings, including those already in use, by the June 15, 2015 effective date of Rule 17g-8(a)(1). The Staff notes that the NRSRO's Board subsequently did make all the approvals required by Rule 17g-8(a)(1). The Staff recommended that the NRSRO ensure it adheres to Rule 17g-8(a)(1).

A larger NRSRO did not sufficiently document approval of its methodologies by its Board. In some instances, the NRSRO's Board did not document its approvals of methodologies, and even in instances when it did prepare minutes concerning its approvals of methodologies, such minutes were not sufficiently detailed to demonstrate Board members' active and informed engagement in the process of reviewing and approving the methodologies. Moreover, Board members did not always receive sufficiently detailed information concerning the methodologies prior to approving these methodologies. In addition, the Board only approved quantitative models that were embedded in a particular methodology, but did not receive information specific to these embedded models and did not consider or discuss these models separately from the methodologies. Moreover, the Board did not approve other quantitative models that the NRSRO uses in the ratings process, such as single-use models. Also, the Board did not approve procedures that the NRSRO uses to determine ratings, and it did not appear that the Board was responsible for approving such procedures. The Staff recommended that the NRSRO's Board adhere to its policies and procedures concerning Board approval as required by Rule 17g-8(a)(1), and that the NRSRO ensure that such Board approval is sufficiently documented.

At a smaller NRSRO, policies and procedures did not explicitly identify the Board members responsible for approving the procedures and methodologies, including qualitative and quantitative data and models, as required by Rule 17g-8(a)(1), and in some instances there were inconsistencies between the Board members who completed such approvals and those who were required to complete such approvals pursuant to its policies and procedures and Board resolutions. In addition, the NRSRO's Board only approved quantitative models that were embedded in a particular methodology, but did not receive information specific to these embedded models and did not consider or discuss these models separately from the methodologies. Moreover, the NRSRO's Board did not approve other quantitative models that

this NRSRO uses in the ratings process, such as single-use models. Finally, the NRSRO's Board did not approve procedures that the NRSRO uses to determine ratings, and it did not appear that the Board was responsible for approving such procedures. The Staff recommended that the NRSRO revise its policies, procedures, and related documents to reflect the Board's responsibilities to approve all of its methodologies, models, and procedures used for determining ratings as required by Rule 17g-8(a)(1). The Staff also recommended that the NRSRO adhere to these policies and procedures and related documents, and ensure that Board approval of procedures, methodologies, and models is sufficiently documented.

At a smaller NRSRO, policies and procedures stated that the Board is responsible for approving changes to its existing methodologies but did not also state that the Board was responsible for approving new methodologies. These policies and procedures also did not state that the Board is responsible for approving models that the NRSRO uses to determine ratings. Also, the NRSRO did not sufficiently document its Board's approval of existing methodologies in minutes or other materials, and there was no indication from minutes and other materials that the Board approved the NRSRO's models. The Staff recommended that the NRSRO revise its policies, procedures, and related documents to reflect the Board's responsibilities to approve procedures, methodologies, and models as required by Rule 17g-8(a)(1). The Staff also recommended that the NRSRO adhere to these policies and procedures and related documents, and ensure that Board approval of procedures, methodologies, and models is sufficiently documented.

A smaller NRSRO's policies and procedures did not state that this NRSRO's Board is responsible for approving procedures that the NRSRO uses to determine ratings or qualitative and quantitative models that the NRSRO uses to determine ratings, and the NRSRO's Board did not approve such procedures and models. A larger NRSRO's and two smaller NRSROs' policies and procedures did not state that the Boards are responsible for approving procedures that the NRSRO uses to determine ratings, and these NRSROs' Boards did not approve such procedures. The Staff recommended that these NRSROs revise their policies and procedures and related documents to reflect the Board's responsibilities to approve procedures and models used to determine ratings as required by Rule 17g-8(a)(1) and ensure that their Board's sufficiently document their approvals of procedures, methodologies, and models.

2. Certain NRSROs, and/or the individuals serving as independent directors of these NRSROs' Boards, did not satisfy Board independence requirements. Also, one NRSRO did not have effective controls to ensure that individuals serving as independent directors satisfied the independence requirements.

During part of the Review Period, the Boards of certain larger NRSROs did not have the sufficient number of independent directors required by Section 15E(t)(2)(A) and their own governing documents. The Staff recommended that the NRSROs ensure their Boards comply with the structural requirements of Section 15E(t), including those concerning independent directors.

At a smaller NRSRO, two directors that the NRSRO identified as independent also served as directors of a non-NRSRO affiliate. By serving as directors on a non-NRSRO affiliate, these

individuals constituted persons associated with the NRSRO and thus were not independent. The Staff recommended that the NRSRO ensure that its corporate governance structure meets the requirements of Section 15E(t), including that individuals serving as independent directors satisfy the independence requirements of Section 15E(t)(2).

At a smaller NRSRO, a director the NRSRO identified as independent performed consulting services for that NRSRO which were not related to this individual's service as an independent director and for which this individual received additional compensation, in violation of Section 15E(t)(2)(B)(i)(I). The Staff recommended that the NRSRO ensure its independent directors satisfy the independence requirements of Section 15E(t)(2)(B).

At a smaller NRSRO, there were weaknesses in the process, analysis, and documentation for reviewing independent directors' questionnaires and ensuring their compliance with Section 15E(t)(2). The Staff recommended that the NRSRO ensure that independent directors' questionnaires are thoroughly and completely reviewed and that independent directors are notified of their obligations as required by the NRSRO's policies and procedures. The Staff also recommended that the NRSRO consider implementing policies and procedures for documenting communications with independent directors concerning their questionnaires.

3. There were weaknesses with certain NRSROs' policies and procedures and other documents governing the responsibilities and obligations of the directors and/or the Board.

At a larger NRSRO, independent directors were not subject to restrictions required by applicable laws concerning certain conflicts of interest, such as those related to securities ownership. The Staff recommended that the NRSRO enhance its policies and procedures to ensure that its independent directors are subject to all applicable laws, including those related to conflicts of interest.

At a smaller NRSRO, the policies and procedures concerning the Board's responsibilities referred to other NRSRO policies and procedures that are outdated or no longer in effect. The Staff recommended that the NRSRO ensure that the documents governing its Board responsibilities are current and accurate.

A smaller NRSRO did not comply with applicable legal requirements concerning revisions to documents governing its Board's structure and responsibilities. The Staff recommended that the NRSRO ensure it complies with all such applicable legal requirements.

F. Review Area: DCO Activities

The DCO role is a critical element to ensure an NRSRO's compliance with securities laws. Each NRSRO's DCO should have adequate resources, institutional support, and independence to effectively carry out the DCO's statutory obligations. During the 2016 examinations, the Staff reviewed the role and activities of each NRSRO's DCO and interviewed each DCO.

The Staff's essential findings regarding the NRSROs' DCO activities are as follows:

1. Certain NRSROs did not promptly produce complete and accurate documents to the Staff as required by applicable laws.

A smaller NRSRO did not have effective internal controls to ensure it makes timely and complete productions to the Staff as required by Rule 17g-2(f). For example, when responding to Staff requests for emails, the NRSRO relied on the individual email recipients to identify all such emails and attachments for production, rather than searching the NRSRO's internal systems for potentially responsive documents or having the DCO assist in identifying responsive documents. In addition, the NRSRO's productions to the Staff did not include all applicable documents requested. The Staff recommended that the NRSRO enhance its internal controls, including policies and procedures, for the retention and production of rating files and communications concerning particular rating actions.

A larger NRSRO's productions to the Staff of documents concerning its rating activities for a particular type of ABS were untimely and disorganized. At a smaller NRSRO, certain documents responsive to the Staff's document request, such as Board minutes, tracking logs, and information concerning models and IT, were missing from initial productions and were only provided after follow-up by the Staff. The Staff recommended that the NRSROs ensure that their productions to the Staff are prompt and complete as required by Sections 17(a) and (b) and Rule 17g-2(f).

2. There were weaknesses in the compliance department's monitoring activities at certain NRSROs.

At a larger NRSRO, a significant number of analysts' emails were not subject to regular email monitoring as required by this larger NRSRO's policies and procedures. The NRSRO's self-assessment of this incident indicated that inadequate resources for email monitoring may have contributed to this email monitoring gap. The Staff recommended that the NRSRO ensure it maintains internal controls, including adequate resources, to conduct email monitoring effectively and consistently with its policies and procedures.

At a smaller NRSRO, periodic compliance questionnaires completed by some personnel to certain questions indicated some instances of potential non-adherence to or risks associated with protection of MNPI, but the NRSRO's compliance staff did not appear to take any follow-up measures based on these responses. The Staff recommended that the NRSRO establish, maintain, enforce, and document policies, procedures, and internal controls concerning the review of periodic compliance response sheets to ensure it meets the requirements of Section 15E(j)(1).

At a smaller NRSRO, the Staff observed that compliance logs did not list certain incidents that should have been listed, and some of the entries on these logs contained incorrect information.

The Staff recommended that the NRSRO enhance the completeness and accuracy of its compliance logs to ensure it meets the requirements of Section 15E(j)(1).

3. At certain NRSROs, the staffing levels and/or quality of work product by the compliance department needed improvement.

At a smaller NRSRO, there has been continuing turnover of compliance staff, which may weaken the effectiveness and the continuity of the NRSRO's compliance function and its ability to satisfy the requirements of Section 15E(j). The NRSRO's compliance staff also did not exercise sufficient oversight of a regional office that employs several analytical personnel. The NRSRO's compliance staff had never visited the regional office and there was limited documentation of compliance oversight over this office. The Staff recommended that the NRSRO enhance its efforts to recruit, train, and retain compliance staff to create greater stability within its compliance function, and that it strengthen its compliance oversight and reporting related to this regional office.

At a smaller NRSRO, the DCO report required by Section 15E(j)(5) provided the incorrect filing date and compliance reports and logs were missing certain information or contained inaccurate information. There were also weaknesses in the NRSRO's internal controls, including policies and procedures, for providing required compliance training to all applicable personnel in a timely manner. While the NRSRO indicated that it requires all NRSRO personnel and certain consultants to complete compliance training in a timely manner, this NRSRO's policies and procedures did not explicitly contain this requirement. In addition, the Staff identified several NRSRO personnel and consultants who had not completed compliance training in a timely manner, and the NRSRO did not effectively track completion of compliance training. The Staff recommended that the NRSRO improve internal controls relating to the quality of its compliance department's work product, and enhance its compliance training program to ensure that its personnel and appropriate consultants complete required compliance training on a timely basis.

G. Review Area: Complaints

All the NRSROs have written policies and procedures to address complaints generally. The Staff's essential findings regarding complaints are as follows:

1. At certain NRSROs, policies and procedures concerning complaints did not satisfy the statutory requirements or NRSRO personnel did not adhere to policies and procedures concerning complaints.

A larger NRSRO did not have procedures for sales and marketing personnel to submit complaints, and the NRSRO's sales and marketing personnel did not receive training concerning complaints. Also at this NRSRO, a junior analyst reported a complaint concerning potential violations of applicable laws and the NRSRO's policies to his analytical supervisor. However, in contravention of the NRSRO's policies and procedures concerning complaints, the junior analyst did not report this potential violation to the compliance department, and the analytical supervisor

did not log the complaint. The Staff recommended that the NRSRO ensure that it maintains adequate policies and procedures for handling complaints as required by Section 15E(j)(3) and that it ensure all employees adhere to these policies and procedures.

At a smaller NRSRO, the definition of complaint contained in its policies and procedures did not include complaints concerning models, methodologies, and compliance with policies and procedures developed pursuant to Section 15E, as required by Section 15E(j)(3)(A). In addition, the NRSRO's personnel did not fully understand the process for logging and evaluating complaints it received. The Staff recommended that the NRSRO enhance its policies and procedures for the receipt, retention, and treatment of complaints to fully comply with Section 15E(j)(3), and ensure that its personnel understand and adhere to these policies and procedures.

A smaller NRSRO's complaint policies and procedures did not fully and sufficiently address oral complaints. The Staff recommended that the NRSRO enhance its complaint policies and procedures to clearly and sufficiently address oral complaints and satisfy Section 15E(j)(3).

A smaller NRSRO's policies and procedures did not require its personnel to consult with its compliance department regarding whether a particular communication may constitute a complaint. Moreover, the Staff observed that this NRSRO received several communications from an investor concerning its application of its methodology and transparency of the rating process, but it did not consider whether these communications constituted complaints. The Staff recommended that the NRSRO enhance its policies and procedures related to complaints to ensure that its compliance department is consulted regarding communications that may constitute complaints, and to ensure that its personnel receive adequate training concerning identifying and handling complaints and adhere to the requirements of Section 15E(j)(3) and its policies and procedures.

At a larger NRSRO, certain employees were unaware that communications from a third-party stating that the NRSRO did not follow its rating methodologies would constitute a complaint pursuant to Section 15E(j)(3) and its policies and procedures, and were not familiar with the process for handling communications that are potentially complaints. The Staff recommended that the NRSRO enhance its training of analysts concerning the identification, handling, and reporting of external complaints.

H. Review Area: Post-Employment

The Staff reviewed whether each NRSRO's "look-back" policies and procedures satisfy the applicable statutory and Rule requirements. The Staff also requested information from each NRSRO concerning personnel that departed the NRSRO during the Review Period, and in some instances tested, on a selected and randomized basis, documentation related to such personnel to assess whether the NRSRO adhered to its look-back policies and procedures and satisfied the statutory and Rule obligations. In addition, OCR sent a letter to each NRSRO reminding it of its requirements under Section 15E(h)(4)(A) and expressing the Staff's view that under Section

15E(h)(4)(A), the look-back review period is determined based on the date of the NRSRO's most recent rating action prior to the employee's departure.⁴⁶

The Staff's essential findings regarding NRSROs' look-back policies and procedures are as follows:

1. There were weaknesses in post-employment policies, procedures, and controls at certain NRSROs.

At a smaller NRSRO, there were two different and conflicting look-back policies in effect for part of the Review Period. Also, this NRSRO's look-back procedure did not include provisions required by Rule 17g-8(c)(2) concerning promptly publishing a revised rating if the previous rating was influenced by a conflict of interest. Moreover, the Staff found incorrect or incomplete information in numerous questionnaires that the NRSRO used to assess whether a look-back review should be conducted and to assist with the review if it is required. The Staff recommended that the NRSRO revise its look-back policies, procedures, and questionnaires to ensure full compliance with Section 15E(h)(4)(A) and Rule 17g-8(c), and ensure that it completes and reviews look-back questionnaires in accordance with its policies and procedures and conducts look-back reviews where required.

A smaller NRSRO's post-employment policies and procedures were vague, inconsistent, and did not satisfy all requirements of Sections 15E(h)(4) and (5) and Rule 17g-8(c). For example, these policies and procedures only required the NRSRO to conduct a look-back if a former employee becomes employed by an issuer that it rated, even though Section 15E(h)(4) also requires look-backs if a covered employee obtains employment with certain obligors, underwriters, or sponsors. The Staff recommended that the NRSRO review and enhance its post-employment policies and procedures to ensure they meet the requirements of Sections 15E(h)(4) and (5) and Rule 17g-8(c).

The look-back policies and procedures of a larger NRSRO and a smaller NRSRO did not require the proper rating action or actions to be reviewed. The larger NRSRO only reviewed the current rating of the issuer, underwriter, or sponsor that employs the former NRSRO employee, even if that rating was determined after the former employee's departure from the NRSRO. Moreover, this NRSRO did not review other ratings of that issuer, underwriter, or sponsor that occurred during the one-year look-back period specified by Section 15E(h)(4)(A). The smaller NRSRO only reviewed rating actions during the one-year period in which the former employee participated, even though Section 15E(h)(4)(A) requires reviews of all ratings of the applicable issuer, underwriter, or sponsor during the one-year look-back review period, regardless of whether the former employee participated in determining all of those ratings. The Staff

⁴⁶ Letter from OCR Director Thomas J. Butler (July 18, 2016), available on OCR's webpage of the SEC's public website, at <https://www.sec.gov/ocr>.

recommended that the NRSROs ensure they conduct look-back reviews for all credit rating actions during the look-back review period, as required by Section 15E(h)(4)(A).

A smaller NRSRO did not review the email communications of a former employee who obtained employment with an issuer it rated to determine whether the former employee attempted to influence this NRSRO's rating of the issuer, as required by its policies and procedures. The Staff recommended that the NRSRO ensure it adheres to its look-back review policies and procedures.

A former senior officer of a smaller NRSRO obtained employment with a covered entity that the NRSRO rated. This covered entity published a press release announcing the hiring of this former senior officer, and the NRSRO's DCO appeared to be aware of the former senior officer's new employment. However, the NRSRO did not file an employee transition report with the Commission until several months after the former senior officer's new employment. The Staff recommended that the NRSRO ensure that it reports information concerning former employees and their new employers as required by Section 15E(h)(5).

V. CONCLUSION

The Staff has identified findings and recommendations for the NRSROs. In future examinations, the Staff will continue to assess the NRSROs' responses to recommendations from the 2016 Section 15E examinations and from previous examinations.

The Staff will continue to evaluate its risk assessment process to review compliance with laws and regulations and to identify emerging risk areas promptly. The Staff will also continue to evaluate exam techniques to assess and test NRSROs' compliance with applicable laws. In addition, the Staff will continue to assess the NRSROs' compliance with the new and amended SEC rules, and expects enhanced compliance by the NRSROs with these rules.