



Legislative Bulletin.....July 12, 2006

Contents:

H.R. 2990—Credit Rating Agency Duopoly Relief Act

Summary of the Bills Under Consideration Today:

Total Number of New Government Programs: 0

Total Cost of Discretionary Authorizations: \$3 million over five years

Effect on Revenue: \$0

Total Change in Mandatory Spending: \$0

Total New State & Local Government Mandates: 0

Total New Private Sector Mandates: Several new registration requirements

Number of Bills Without Committee Reports: 0

Number of Reported Bills that Don't Cite Specific Clauses of Constitutional Authority: 0

**H.R. 2990—Credit Rating Agency Duopoly Relief Act—as reported
(Fitzpatrick, R-PA)**

Order of Business: The bill is scheduled to be considered on Wednesday, July 12th, subject to a structured rule (H.Res. 906). Summaries of the two amendments made in order are provided below.

Summary: H.R. 2990 would replace the Securities and Exchange Commission's (SEC) staff's subjective role in designating credit rating agencies (i.e. agencies rating debt securities, like bonds) as Nationally Recognized Statistical Rating Organizations (NRSROs) with a voluntary, more objective registration system for those agencies who want their ratings to be able to be used for federal regulatory purposes. Under current law, there is no formal

registration process; SEC staff currently recognize five credit rating agencies as NRSROs. Rating agencies that have issued fee-based credit ratings for at least three years using a quantitative or qualitative model to determine its publicly available ratings and registered with the SEC would be eligible to be NRSROs.

NRSROs would be required to disclose as part of their applications (in an electronically-accessible format) their long-term, mid-term, and short-term statistical record at rating securities and public companies, the methods they use in deriving their ratings, any conflicts their respective practices create (and how such conflicts are resolved), and their respective organizational structures. NRSROs would also be required to implement systematic procedures to manage conflicts of interest and prevent the misuse of non-public information.

The SEC would have 90 days to either approve an application or initiate procedures for its denial. This timeframe could be extended upon agreement with the applicant. NRSROs would have to update their registration information annually with the SEC, and the SEC could take disciplinary action (including revoking a registration) against an NRSRO that violates the terms of its registration.

The SEC would be instructed to inspect, examine, and bring enforcement actions under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.). NRSROs would have to appoint a chief compliance officer to ensure compliance with applicable securities laws and regulations.

It would be illegal for NRSROs to:

- make use of the mail or any means or instrumentality of interstate commerce in connection with its business as a statistical rating organization, unless it is in compliance with this bill's registration requirements; and
- represent or imply that they have been sponsored, recommended, or approved by any federal entity or officer.

SEC would be given 180 days from this bill's enactment to review and, if necessary, revise its regulations that use the term "NRSRO." The SEC could adopt rules or regulations to prohibit NRSROs from engaging in any act or practice the SEC deems to be unfair, coercive, or abusive (including seeking payment for unsolicited ratings and issuing or modifying ratings on the condition of the customer purchasing other services from the credit rating agency).

Subsequent to registration, NRSROs would have to file, in a non-public way with the SEC, audited financial statements and any other SEC-required information relating to financial health.

H.R. 2990 would make NRSROs subject to the reporting and recordkeeping requirements of the Securities Exchange Act of 1934 (such as those for those for mutual funds, investment advisors, and brokers).

The registration regime created by this legislation would not go into effect until January 1, 2008. Thirty days after enactment of this legislation, the SEC could no longer enforce its existing rules on NRSROs (17 CFR 240.15c3-1).

H.R. 2990 would require the U.S. Comptroller General (in consultation with other entities listed in the bill) to report to Congress within 180 days of this bill's enactment on:

- the factors that have led to the consolidation of credit rating agencies;
- the present and future impact of such consolidation on domestic and international securities markets and on individual businesses;
- solutions to any problem impacts identified above; and
- whether and to what extent federal or state regulations impede competition among credit rating agencies.

The bill notes, regarding credit rating agencies, that “their ratings, publications, writings, analyses, and reports customarily relate to the purchase and sale of securities traded on securities exchanges and in interstate over-the-counter markets, securities issued by companies engaged in business in interstate commerce, and securities issued by national banks and member banks of the Federal Reserve System; and the foregoing transactions occur in such volume as substantially to affect interstate commerce, and securities markets, the national banking system, and the national economy.”

Additional Background: The five NRSROs are A.M. Best Company, Inc.; Dominion Bond Rating Service Limited; Fitch, Inc; Moody's Investors Service, Inc.; and the Standard & Poor's Division of the McGraw Hill Companies, Inc. (Moody's and S&P are the two dominant ones.).

Amendments Made in Order under the Rule (H.Res. 906):

Oxley (R-OH). Manager's Amendment. Clarifies that there is no private right of action for NRSROs under the Securities Exchange Act of 1934 by changing the bill's “filing” requirements to “furnishing” requirements. [Current securities law allows private rights of action against certain filings.] Allots to the SEC an additional six months (for a total of one year) to review and, if necessary, revise its regulations that use the term “NRSRO.” Makes a variety of truly technical amendments clarifying definitions, findings, and disclosure requirements. (*Debatable for ten minutes*)

Kanjorski (D-PA/ Frank (D-MA). Amendment in the Nature of a Substitute. Requires the SEC to complete its definitional rulemaking on what constitutes an NRSRO within 60 days of enactment and establish public guidelines about the process used to identify new NRSROs within 180 days of enactment. Expresses a variety of findings and a sense of Congress (not a requirement) that the credit ratings industry should self-regulate through a voluntary framework. Requires the SEC to testify at annual congressional hearings on rating agencies for five years regarding the effectiveness of any self-regulatory regime established and the need for federal action. (*Debatable for twenty minutes*)

Committee Action: On June 20, 2005, H.R. 2990 was referred to the Financial Services Committee, which (on June 14, 2006) marked up and ordered the bill reported to the full House by voice vote.

Possible Conservative Concerns: A leading RSC Member had expressed concerns that this bill could allow for trial lawyers to sue NRSROs for issues related to their registration with the SEC; however, the manager's amendment made in order under the rule would alleviate such concerns by clarifying that only the SEC could sue the NRSROs.

Administration Position: Although a formal Administration position is not available, the SEC testified last year before Congress that it favors a more explicit regulatory regime for NRSROs: <http://financialservices.house.gov/media/pdf/041205an.pdf>.

Cost to Taxpayers: CBO estimates that this bill would cost \$3 million over the FY2007-2011 period and would not affect direct spending or revenues.

Does the Bill Expand the Size and Scope of the Federal Government?: No.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: CBO confirms that the new registration requirements in the bill would be considered private-sector mandates.

Constitutional Authority: The Financial Services Committee, in House Report 109-546, cites constitutional authority in Article 1, Section 8, Clause 1 (relating to the general welfare of the United States) and Clause 3 (relating to the power to regulate interstate commerce).

RSC Staff Contact: Paul S. Teller, paul.teller@mail.house.gov, (202) 226-9718