

**SECURITIES AND EXCHANGE COMMISSION**  
**Release No. 34-76129**

**October 13, 2015**

**Order Granting Temporary, Limited, and Conditional Exemption of Kroll Bond Rating Agency, Inc. from the Conflict of Interest Prohibition in Rule 17g-5(c)(1) of the Securities Exchange Act of 1934**

**I. Introduction**

Rule 17g-5(c)(1) of the Securities Exchange Act of 1934 (“Exchange Act”) prohibits a nationally recognized statistical rating organization (“NRSRO”) from issuing or maintaining a credit rating solicited by a person that, in the most recently ended fiscal year, provided the NRSRO with net revenue equaling or exceeding 10% of the total net revenue of the NRSRO for the fiscal year. In adopting this rule, the Securities and Exchange Commission (“Commission”) stated that a person soliciting a credit rating who was the source of 10% or more of the total net revenue of the NRSRO would be in a position to exercise substantial influence on the NRSRO, which in turn would make it difficult for the NRSRO to remain impartial given the impact on the NRSRO’s income if the person withdrew its business.<sup>1</sup> Section 36 of the Exchange Act authorizes the Commission to exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

**II. Exemption Request of Kroll Bond Rating Agency, Inc.**

Kroll Bond Rating Agency, Inc. (“KBRA”), formerly known as LACE Financial Corp. (“LACE”), is a credit rating agency registered with the Commission as an NRSRO under section 15E of the Exchange Act for the classes of credit ratings described in clauses (i) through (v) of

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<sup>1</sup> Release No. 34-55857 (June 5, 2007), 72 FR 33564, 33598 (June 18, 2007).

section 3(a)(62)(A) of the Exchange Act. The Commission has previously granted KBRA two temporary exemptions from Rule 17g-5(c)(1): (1) until January 1, 2013, in connection with its entering the market for rating structured finance products (“First KBRA Order”);<sup>2</sup> and (2) until January 1, 2015, to allow KBRA to continue to diversify its business beyond commercial mortgage-backed securities (“CMBS”) ratings (“Second KBRA Order”).<sup>3</sup> The Commission also previously granted a temporary exemption from Rule 17g-5(c)(1) to LACE in connection with its initial registration as an NRSRO (“LACE Order” and, collectively with the First KBRA Order and Second KBRA Order, “Previous Exemptive Orders”).<sup>4</sup>

KBRA has informed the Commission that while its revenues have been derived increasingly from a diversified group of issuers beyond the CMBS market, factors outside of KBRA’s control have continued to limit its ability to grow its business in certain sectors. Specifically, KBRA states that the number of CMBS issuers in the market is limited, and that business development in other rating areas has been affected by market conditions and barriers to entry. Accordingly, KBRA has requested an extension of its exemption from Rule 17g-5(c)(1), until January 1, 2017, to enable the continued growth of its business and, thereby, foster competition in the credit rating industry.

### **III. Discussion**

The Commission, when adopting Rule 17g-5(c)(1), noted that it intended to monitor how the prohibition operates in practice, particularly with respect to asset-backed securities, and

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<sup>2</sup> Release No. 34-65339 (Sept. 14, 2011), 76 FR 58319, 58321 (Sept. 20, 2011).

<sup>3</sup> Release No. 34-71220 (Dec. 31, 2013).

<sup>4</sup> Release No. 34-57301 (Feb. 11, 2008), 73 FR 8720 (Feb. 14, 2008).

whether exemptions may be appropriate.<sup>5</sup> The Commission noted several factors in granting the Previous Exemptive Orders, including that the exemptions would further the primary purpose of the Credit Rating Agency Reform Act of 2006 (“Rating Agency Act”) to “improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry.”<sup>6</sup> Citing the same factors, the Commission has issued similar orders granting temporary exemptions from the requirements of Rule 17g-5(c)(1) to Realpoint LLC, in connection with its registration as an NRSRO,<sup>7</sup> and to Morningstar Credit Ratings, LLC, the successor to Realpoint LLC.<sup>8</sup>

KBRA has informed Commission staff that in the current fiscal year, KBRA may receive more than 10% of its total net revenue from one or more clients that paid it to rate asset-backed securities. In the request that is subject to this Order, KBRA states that it expects to have more diversified revenue sources over time and that a temporary extension of the exemption from Rule 17g-5(c)(1) would enable the continued growth of its business so that eventually it will be able to operate without an exemption.

The Commission believes that a temporary, limited, and conditional exemption allowing KBRA to continue to diversify its business beyond CMBS ratings is consistent with the Commission’s goal, as established by the Rating Agency Act, of improving ratings quality by fostering accountability, transparency, and competition in the credit rating agency industry and is necessary or appropriate in the public interest and consistent with the protection of investors. In

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<sup>5</sup> Release No. 34-55857, 72 FR 33598.

<sup>6</sup> Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Rating Agency Act, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006).

<sup>7</sup> Release No. 34-58001 (June 23, 2008), 73 FR 36362 (June 26, 2008).

<sup>8</sup> Release No. 34-66514 (Mar. 5, 2012), 77 FR 14580 (Mar. 12, 2012); Release No. 34-71219 (Dec. 31, 2013).

order to maintain this exemption, KBRA will be required to comply with the following conditions: (1) KBRA shall review, update, maintain, comply with, and document policies, procedures, and internal controls specifically designed to address the conflict of interest created by exceeding the 10% threshold, including that KBRA's Designated Compliance Officer ("DCO") shall: (a) conduct and document, on at least a quarterly basis, a review of a sample of rating files from its 2015, 2016, and 2017 fiscal years for credit ratings solicited by the applicable client or clients that provided KBRA with 10% or more of its total net revenue, and take other steps acceptable to the Commission's examination staff, to verify that ratings of any such clients were not influenced by commercial concerns and that KBRA adhered to such policies, procedures, and internal controls; and (b) deliver quarterly written reports about these efforts to KBRA's Chief Executive Officer ("CEO") and board of directors; (2) within 5 business days after the end of each quarter beginning with the last quarter of its 2015 fiscal year and through the end of its 2017 fiscal year, KBRA's CEO shall file with the Commission a certification that all credit ratings issued through the end of each such quarter on deals for any client or clients that provided KBRA with 10% or more of its total net revenue sufficiently adhered to its policies, procedures, and internal controls to address the conflict of interest created by exceeding the 10% threshold, that the DCO took appropriate measures, including rating file reviews, to confirm this adherence, and that identifies the credit ratings issued for any such clients during such quarter; (3) KBRA shall appropriately address the Commission staff's findings and recommendations in the 2015 annual section 15E(p)(3) examination and any other examinations conducted by Commission staff during 2015, 2016, or 2017; (4) net revenue received by KBRA from a single client may not exceed 19.5% of KBRA's total net revenue for either the fiscal year ending December 31, 2015 or the fiscal year ending December 31, 2016; (5)

KBRA shall publicly disclose, as applicable, in Exhibit 6 to Form NRSRO that it received 10% or more of its total net revenue in fiscal years 2015 and 2016 from a client or clients; and (6) KBRA shall retain documentation demonstrating compliance with the conditions of the exemption.

Section 15E(p)(3) of the Exchange Act, as added by section 932(a)(8) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, requires the Commission's Office of Credit Ratings ("OCR") to conduct an examination of each NRSRO at least annually. As an integrated part of the applicable annual examinations, OCR staff will examine KBRA's satisfaction of the conditions to this Order set forth in section IV below. If the conditions are not being fulfilled to the staff's satisfaction, the staff will consider whether to recommend that the Commission take additional action, administrative or otherwise.

#### **IV. Conclusion**

Accordingly, pursuant to section 36 of the Exchange Act,

IT IS HEREBY ORDERED that KBRA is exempt from the conflict of interest prohibition in Exchange Act Rule 17g-5(c)(1) until January 1, 2017 with respect to any revenue derived from issuer-paid credit ratings, provided that: (1) KBRA shall review, update, maintain, comply with, and document policies, procedures, and internal controls specifically designed to address the conflict of interest created by exceeding the 10% threshold, including that KBRA's DCO shall: (a) conduct and document, on at least a quarterly basis, a review of a sample of rating files from its 2015, 2016, and 2017 fiscal years for credit ratings solicited by the applicable client or clients that provided KBRA with 10% or more of its total net revenue, and take other steps acceptable to the Commission's examination staff, to verify that ratings of any such clients were not influenced by commercial concerns and that KBRA adhered to such

policies, procedures, and internal controls; and (b) deliver quarterly written reports about these efforts to KBRA's CEO and board of directors; (2) within 5 business days after the end of each quarter beginning with the last quarter of its 2015 fiscal year and through the end of its 2017 fiscal year, KBRA's CEO shall file with the Commission a certification that all credit ratings issued through the end of each such quarter on deals for any client or clients that provided KBRA with 10% or more of its total net revenue sufficiently adhered to its policies, procedures, and internal controls to address the conflict of interest created by exceeding the 10% threshold, that the DCO took appropriate measures, including rating file reviews, to confirm this adherence, and that identifies the credit ratings issued for any such clients during such quarter; (3) KBRA shall appropriately address the Commission staff's findings and recommendations in the 2015 annual section 15E(p)(3) examination and any other examinations conducted by Commission staff during 2015, 2016, or 2017; (4) net revenue received by KBRA from a single client shall not exceed 19.5% of KBRA's total net revenue for either the fiscal year ending December 31, 2015 or the fiscal year ending December 31, 2016; (5) KBRA shall publicly disclose, as applicable, in Exhibit 6 to Form NRSRO that it received 10% or more of its total net revenue in fiscal years 2015 and 2016 from a client or clients; and (6) KBRA shall retain documentation demonstrating compliance with the conditions of the exemption.

By the Commission.

Brent Fields  
Secretary