Background Information
Meeting of the Fixed Income Market Structure Advisory Committee
Panel on Alternative Compensation Models for Credit Rating Agencies
November 4, 2019

- In a January 2012 Report (GAO-12-240) on *Alternative Compensation Models for Nationally Recognized Statistical Rating Organizations* (NRSROs), the U.S. Government Accountability Office (GAO) identified the following seven alternative models for compensating NRSROs:

Name	Description
Random selection	Issuers continue to pay for ratings but payment is made to a ratings board that randomly assigns NRSROs to rate issuances.
Investor-owned	Institutional investors create and operate an NRSRO. Issuers are required to get two ratings, one from the investor-owned NRSRO and one from an NRSRO of their choice.
Stand-alone	NRSROs choose which issues to rate. A transaction fee for original issuance and fees from secondary market transactions pay for the ratings.
Designation	NRSROs choose which issues to rate and securities holders designate which NRSRO(s) would receive the fees they pay for rating(s). A third party collects and distributes fees.
User-pays	Third-party auditors determine who is "using" ratings and require that all "users" pay the NRSROs.
Alternative user-pays	Creditors' resources are pooled and a government agency or independent board uses these resources to solicit ratings. NRSROs bid on the right to rate products.
Issuer and investor-pays	Issuers and investors pay a fee on the issuance of new debt and secondary market trades. NRSROs are placed in a continuous queue and assigned to rate issues as their number comes up. Assignment eventually is based on an NRSRO's performance.

Source: GAO 12-240

- The GAO's January 2012 Report included the following framework with seven factors for evaluating alternative models for compensating NRSROs, which was also set forth in an earlier GAO Report (GAO-10-782):

Factors	Description
Independence	The ability for the compensation model to mitigate conflicts of interest inherent between the entity paying for the rating and the NRSRO. Key questions include: What potential conflicts of interest exist in the alternative compensation model and what controls, if any, would need to be implemented to mitigate these conflicts?
Accountability	The ability of the compensation model to promote NRSROs' responsibility for the accuracy and timeliness of their ratings. Key questions include: How does the compensation model create economic incentives for NRSROs to produce quality ratings over the bond's life? How is NRSRO performance evaluated and by whom?

Factors	Description
Competition	The extent to which the compensation model creates an environment in which NRSROs compete for customers by producing higher-quality ratings at competitive prices. Key questions include: To what extent does the compensation model encourage competition around the quality of ratings, ratings fees, and product innovation? To what extent does it allow for flexibility in the differing sizes, resources, and specialties of NRSROs?
Transparency	The accessibility, usability, and clarity of the compensation model and the dissemination of information on the model to market participants. Key questions include: How transparent are the model's processes and procedures for determining ratings fees and compensating NRSROs? How would NRSROs obtain ratings business?
Feasibility	The simplicity and ease with which the compensation model can be implemented in the securities market. Key questions include: What are the costs to implement the compensation model and who would fund them? Who would administer the compensation model? What, if any, infrastructure would be needed to implement it?
Market acceptance and choice	The willingness of the securities market to accept the compensation model, the ratings produced under that model, and any new market players established by the compensation model. Key questions include: What role do market participants have in selecting NRSROs to produce ratings, assessing the quality of ratings, and determining NRSRO compensation?
Oversight	The evaluation of the model to ensure it works as intended. Key questions include: Does the model provide for an independent internal control function? What external oversight does the compensation model provide to ensure it is working as intended?

Source: GAO 10-782 and 12-240

- In December 2012, staff of the U.S. Securities and Exchange Commission (Commission) issued a Report to Congress on Assigned Credit Ratings. The staff recommended that the Commission convene a roundtable at which proponents and critics of the three courses of action would be invited to discuss the study and its findings.

- In May 2013, the Commission held a public Credit Ratings Roundtable consisting of three panels:

    - The first panel discussed the potential creation of a credit rating assignment system for asset-backed securities;

    - The second panel discussed the effectiveness of the Commission's current system to encourage unsolicited ratings of asset-backed securities (Rule 17g-5 of the Securities Exchange Act of 1934, as amended); and

    - The third panel discussed other alternatives to the current issuer-pay business model in which the issuer selects and pays the firm it wants to provide credit ratings for its securities.