Earning a "C" for Rulemaking: The Ambiguity and Potential Impact of a Recent SEC Rule Governing Nationally Registered Statistical Rating Organizations*

INTRODUCTION

Imagine the world's richest person, Bill Gates, and his more than $80 billion net worth.[1] Now imagine 136 equally wealthy individuals, whose combined $11 trillion net worth[2] would exceed the 2013 gross domestic product ("GDP") of every country in the world except for the United States.[3] Finally, imagine that all of these individuals and their associated wealth very quickly disappeared, such that every person even remotely tied to them and their enterprises felt the ensuing negative repercussions. Such was the magnitude of the 2008 global financial crisis.[4]

Nationally registered statistical rating organizations' ("NRSRO")[5] actions exacerbated behavior that ultimately led to the 2008 financial collapse, and these entities have been subjected to additional regulation as the public has become more aware of the credit rating agencies' missteps. Most recently, the Securities and Exchange Commission ("SEC"), on August 27, 2014, promulgated rules[6] pursuant to 2011's Dodd-Frank Wall Street Reform and Consumer Protection Act[7] that established guidelines for credit rating agency behavior.[8] A portion of one of these rules, specifically the second prong of the two-

1. *The World's Billionaires*, FORBES, http://www.forbes.com/billionaires/list/#tab:overall (last visited Jan. 22, 2015).
2. THE FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT, at xv (2011), *available at* http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.
3. *GDP (Current US$)*, WORLD BANK (2014), http://data.worldbank.org/indicator/NY.GDP.MKTP.CD?order=wbapi_data_value_2013+wbapi_data_value+wbapi_data_value-last&sort=desc.
4. *See* THE FIN. CRISIS INQUIRY COMM'N, *supra* note 2, at xv.
5. Throughout this Recent Development, the terms "NRSRO" and "credit rating agency" will be used interchangeably.
6. *See* Press Release, Sec. & Exch. Comm'n, SEC Adopts Credit Rating Agency Reform Rules (Aug. 27, 2014), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542776658#.VB8OI-eT549.
7. Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended at 5, 7, 12, 15, 22, 26, 28, 31, and 42 U.S.C.).
8. *See* Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 34–72936, 79 Fed. Reg. 55,077, 55,108 (Sept. 15, 2014) (to be codified at 17 C.F.R. pts. 232, 240, 249, 249b).

pronged addition of Paragraph (c)(8) of Rule 17g-5,[9] "prohibits an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit or rating, or developing or approving procedures or methodologies used for determining the rating . . . is influenced by sales or marketing considerations."[10] This broad definition of influence is a very vague restriction and will result in an uncertain and ambiguous regulatory landscape where the SEC could bring an action claiming that almost anything influenced a targeted analyst.[11] For this reason, Rule 17g-5(c)(8) will not prove viable over the long run for legal and policy-related reasons.

This Recent Development analyzes the rule's vulnerabilities and argues that the SEC would be wise to remove the ambiguity associated with this rule by issuing a formal clarifying statement that posits what specific behavior the rule covers. The analysis consists of five sections. Part I explains the purpose of credit rating agencies and where they fit within the story of the financial crisis. Part II details the relevant regulatory landscape, characterizes the rule that is the subject of this Recent Development, explains major issues concerning the recently enacted rules, and ultimately profiles one specific problem: the ambiguity of the restriction on analysts being influenced by sales and marketing considerations. Part III details potential legal ramifications of this ambiguity. Part IV explains broader ramifications that may result from this problem. Finally, Part V discusses numerous solutions to this problem and recommends one specific course of action: the issuance of a clarifying statement.

I. FINANCIAL CRISIS AND THE CREDIT RATING AGENCIES' ROLE

Credit rating agencies played a major role in the creation of the financial tumult of the mid-2000s.[12] Before detailing precisely *how* they contributed to the financial crisis, however, it is important to understand the general role that credit rating agencies play in financial markets. Credit rating agencies derive revenue from borrowers asking for ratings or from subscribers to ratings publications and reports.[13]

9. *See id.*

10. *Id.* at 55,249.

11. *See id.* at 55,107.

12. *See* Ryan Voorhees, *Rating the Raters: Restoring Confidence and Accountability in Credit Rating Agencies*, 44 CASE W. RES. J. INT'L L. 875, 875 (2011) (describing ways in which credit rating agencies contributed to the financial crisis).

13. *See Q&A: How Do Credit Ratings Work?*, TELEGRAPH (Feb. 14, 2012), http://www.telegraph.co.uk/finance/financialcrisis/9081354/QandA-How-do-credit-ratings-work.html.

They also determine risk levels associated with specific companies or sovereign entities and offer pertinent data related to various investment vehicles.[14] The rating itself provides an opinion on a company's or sovereign entity's financial soundness and ability to repay debt obligations, which themselves relate to default risk.[15] If an entity carries a low credit rating, all else equal, its costs of borrowing will be higher than an entity with a higher credit rating.[16] The actual ratings are ranked along a spectrum from investment grade on one end to noninvestment grade ("junk") on the other end.[17] Moody's, for example, provides an "AAA" rating to the highest investment grade—debt with the best credit quality—and a "C" rating to the lowest noninvestment grade debt, with nineteen possible intermediate ratings between the two extremes.[18] Giving inappropriate ratings, then, led to investors building models and making complicated decisions based on credit that was rated as healthy but that, in many instances, should have been accorded a lower rating.

Credit rating agencies helped create the dangerous economic reality that arose in the mid-2000s, and in the midst of the recession, former Federal Reserve Chairman Alan Greenspan and acclaimed economist Joseph Stiglitz characterized the agencies as the "core of the problem"[19] and "the [financial crisis's] key culprit."[20] Criticism of credit rating agencies is neither new nor purely a product of the financial crisis.[21] Leading up to the mortgage bubble's burst, investors overrelied on the ratings that the various credit agencies provided.[22]

14. *See id.*

15. *About Credit Ratings*, STANDARD & POOR'S (2012), http://www.standardandpoors.com/aboutcreditratings/RatingsManual_PrintGuide.html.

16. *See id.*

17. *See id.*

18. *See id.*

19. *The Financial Crisis and the Role of Federal Regulators: Hearing Before the H. Comm. on Oversight & Gov't Reform*, 110th Cong. 12 (2008) (testimony of Alan Greenspan, former Chairman of the Federal Reserve Board), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-110hhrg55764/pdf/CHRG-110hhrg55764.pdf.

20. Elliott Blair Smith, *Bringing Down Wall Street as Ratings Let Loose Subprime Scourge*, BLOOMBERG (Sept. 24, 2008), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ah839IWTLP9s ("'[The credit rating agencies] were the party that performed that alchemy that converted the securities from F-rated to A-rated. The banks could not have done what they did without the complicity of the ratings agencies.'").

21. *See* Sam Jones, *How Moody's Faltered*, FIN. TIMES MAG. (Oct. 17, 2008), http://www.ft.com/intl/cms/s/0/65892340-9b1a-11dd-a653-000077b07658.html#axzz3DzHmBhYT (noting that criticism of credit rating agencies dates back to at least 2002, when a subcommittee of the U.S. Senate investigated Enron's collapse).

22. *See* Frank Partnoy, *Overdependence on Credit Ratings Was a Primary Cause of the Crisis* 6 (Univ. of San Diego Sch. of Law Legal Studies Research Paper Series, Research Paper

Such overreliance may have been justified under certain circumstances, but many ratings lacked substance.[23] Ultimately, some critics have blamed overreliance on credit rating agencies as the predominate driver behind the use of the sophisticated investment vehicles—which very few fully understood—that caused the financial collapse.[24]

Credit rating agencies gained increasing influence over time and, ultimately, took many shortcuts around providing straightforward ratings.[25] These shortcuts, then, helped fuel the global financial crisis.[26] Moody's, founded in 1909,[27] derived most of its revenues from selling agency reports to investors until the 1970s.[28] Then a tide shift occurred, and instead of earning its revenue from securities users or investors, the agency (and others like it) began to successfully sell to securities issuers.[29] A former Moody's managing director described the firm as "an information provider . . . [that] researched and [analyzed] companies' financial health, then offered investors its views, to help them decide where to put their money."[30] The industry's duopoly (Standard & Poor's[31] and Moody's) ended when, in the 1990s, Fitch

No. 09-015, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1430653&rec=1&srcabs=1374907 ("Investors typically did not examine the underlying assets of a synthetic CDO or SIV in any detail or at all.").

23. *See id.* ("If the credit rating agencies, and their clients, had used reasonable and accurate models and assumptions, then in principle these transactions might not have been problematic. However, these parties faced financial incentives to use unreasonable and inaccurate assumptions and models to complete deals and thereby earn greater fees.").

24. *See id.* at 1 (noting that "[w]ithout such overdependence [on credit rating agencies], the complex financial instruments . . . which were at the center of the crisis could not, and would not, have been created or sold"*).*

25. *See* Elizabeth Devine, *The Collapse of an Empire? Rating Agency Reform in the Wake of the 2007 Financial Crisis*, 16 FORDHAM J. CORP. & FIN. L. 177, 187 (2011); *see also* Matthew Robinson & Drew McLaughlin, *S&P Ends Legal Woes Paying $1.5 Billion Fine to U.S., States*, BLOOMBERG (Feb. 3, 2015), http://www.bloomberg.com/ news/articles/2015-02-03/s-p-ends-legal-woes-with-1-5-billion-penalty-with-u-s-states ("S&P . . . will pay more than a year's profit to settle suits with the U.S. Justice Department, more than a dozen states and the biggest U.S. pension fund, who alleged the company inflated ratings on the subprime-mortgage bonds at the center of the 2008 crisis.").

26. *See* Smith, *supra* note 20 *(*describing credit rating agencies' reliance on analysis undertaken by competitors in formulating their own ratings*).*

27. RICHARD SYLLA, A HISTORICAL PRIMER ON THE BUSINESS OF CREDIT RATINGS 2 (2001), *available at* http://www1.worldbank.org/finance/assets/images/ Historical_Primer.pdf.

28. *Id.* at 24.

29. *See id.* ("Starting in the 1970s, the agencies shifted their main revenue source from investors and users to the issuers of securities. Now nearly all of the leading agencies' revenue comes from fees . . . charged to issuers.").

30. Jones, *supra* note 21.

31. Standard & Poor's ("S&P") is a purveyor of financial information, including credit ratings. In that capacity, it is one of the nation's largest NRSROs. It recently paid $1.5 billion to settle a suit that inflated credit ratings leading up to the 2008 financial crisis. Christopher

came into its own, capturing market share, thereby allowing banks to ratings shop.[32] Additional systematic changes occurred later, fundamentally altering the structure of many agencies.[33] Finally, internal control systems loosened, further incentivizing risky behavior.[34] Such was the competitive environment the credit rating agencies faced as the mortgage bubble inflated.[35] Despite the NRSROs' impact, the 2008 financial crisis and ensuing recession did not occur in isolation but arose from the confluence of many precursor events, including but not limited to missteps by the credit rating agencies.[36] Much has already been written about the financial crisis's fundamental causes,[37] and as time passes, more actors and entities continue to be implicated for having magnified the spectacular financial collapse.[38]

The recession's causes are mostly known and, with the benefit of hindsight, the consensus is that this crisis could have been avoided[39] and that it resulted from broad-based regulatory failures.[40] Ultimately, high-risk investing, overuse of debt, and market opaqueness combined to create the perfect storm.[41] Despite the crisis's preventability,[42] the

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Alessi, Roya Wolverson & Mohammed Aly Sergie, *The Credit Rating Controversy*, COUNCIL ON FOREIGN REL. (October 22, 2013), http://www.cfr.org/ financial-crises/credit-rating-controversy/p22328; Robinson & McLaughlin, *supra* note 25.

32. Jones, *supra* note 21.

33. *See id.* (describing the 2000 initial public offering of Moody's and the rise to prominence of powerful employees who viewed the ratings business as a service business).

34. *See id.* (describing how the number of mortgage CDOs rated by Moody's skyrocketed when, in 2004, Moody's abolished diversity scores, which "prevented securities with homogenous collateral pools from winning the highest rating").

35. This understanding of how credit rating agencies evolved over time and ultimately faltered is vital to fully comprehending the regulations passed and the problems with the rule at issue in this Recent Development.

36. *See* Mark Koba, *Dodd-Frank Act: CNBC Explains*, CNBC (May 11, 2012), http://www.cnbc.com/id/47075854#.

37. *See generally, e.g.*, JOHN BELLAMY FOSTER & FRED MAGDOFF, THE GREAT FINANCIAL CRISIS: CAUSES AND CONSEQUENCES (2011) (analyzing the financial crisis's causes and speculating as to where markets may head in the future); Andrew W. Hartlage, Book Notice, *"Never Again," Again: A Functional Examination of the Financial Crisis Inquiry Commission*, 111 MICH. L. REV. 1183 (2013) (discussing the Financial Crisis Inquiry Commission's report on the causes of the financial crisis).

38. *See* Larry Elliott, *Who to Blame for the Great Recession? So Many Big Names Are in the Frame*, GUARDIAN (Feb. 3, 2012), http://www.theguardian.com/business/2012/feb/03 /who-caused-financial-crisis-great-recession (listing public figures and world leaders whose actions contributed to the recession).

39. *See* THE FIN. CRISIS INQUIRY COMM'N, *supra* note 2, at xvii.

40. *See id.* at xviii.

41. *See id.* at xix; *see also* U.S. SENATE PERMANENT SUBCOMM. ON INVESTIGATIONS, WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE 2–7 (2011), *available at* http://www.hsgac.senate.gov//imo/media/ doc/Financial_Crisis/FinancialCrisisReport.pdf. (noting that, among other things, "inflated credit ratings" contributed to the financial collapse)

U.S. government lacked adequate preparation, responded inconsistently as the situation spiraled out of control, and thus, only exacerbated the anxiety and ambiguity coursing through financial markets.[43] This panic, then, led to increased system-wide ethical and responsibility-based oversights and failures.[44] In response to these failures, Congress passed the Dodd-Frank Act,[45] which, in turn, led to the SEC Commissioners promulgating the ambiguously worded section (c)(8) of Rule 17g-5.[46]

The crisis's broad drivers manifested themselves most clearly in the mortgage industry.[47] While in the spring of 2004 the homeownership rate of 69.2% represented an all-time high,[48] it had declined to 64.7%—the lowest ownership rate since 1995—by June 2014.[49] Through the mid-2000s, mortgage lenders increasingly loosened their standards.[50] This practice ultimately proved disastrous when mortgagees failed to pay their debts and the securities created from their mortgages rapidly declined in value.[51] Subprime borrowers[52] received loans but often found themselves without the ability to repay them.[53] Banks then passed these high-risk mortgages to

42. *See supra* note 39 and accompanying text.

43. *See* THE FIN. CRISIS INQUIRY COMM'N, *supra* note 2, at xxi.

44. *See id.* at xxii.

45. *Wall Street Reform: The Dodd-Frank Act*, WHITE HOUSE, http://www.whitehouse.gov/economy/middle-class/dodd-frank-wall-street-reform (last visited Mar. 21, 2015) (explaining that "[t]o make sure that a crisis like [the 2008 financial crisis] never happens again, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law").

46. *See infra* note 66 and accompanying text.

47. *See Crash Course*, ECONOMIST (Sept. 7, 2013), http://www.economist.com/news/schoolsbrief/21584534-effects-financial-crisis-are-still-being-felt-five-years-article.

48. *See* THE FIN. CRISIS INQUIRY COMM'N, *supra* note 2, at 5.

49. *See* Press Release, Soc., Econ., & Hous. Statistics Div., U.S. Census Bureau, Residential Vacancies and Homeownership in the Second Quarter 2014 (July 29, 2014), *available at* http://www.census.gov/housing/hvs/files/qtr214/q214press.pdf.

50. *See* Raymond H. Brescia, *Subprime Communities: Reverse Redlining, the Fair Housing Act and Emerging Issues in Litigation Regarding the Subprime Mortgage Crisis*, 2 ALB. GOV'T L. REV. 164, 171 (2009) ("[U]nderwriting standards weakened significantly in the later years of the housing boom, as brokers and originators sought to tap whatever markets there were for potential borrowers, regardless of their viability as such."); *supra* note 34 and accompanying text.

51. *See* THE FIN. CRISIS INQUIRY COMM'N, *supra* note 2, at xxiii.

52. This term refers to debtors whose credit is unhealthier than that of average borrowers.

53. *See Crash Course*, *supra* note 47 ("Low interest rates created an incentive for banks, hedge funds and other investors to hunt for riskier assets that offered higher returns. They also made it profitable for such outfits to borrow and use the extra cash to amplify their investments, on the assumption that the returns would exceed the cost of borrowing.").

financial engineers, who pooled them.[54] Beliefs that property values would continue to rise indefinitely proved false, and home prices across the United States began to decrease beginning in 2006.[55] The housing market's change in direction caused a ripple effect that impacted many aspects of the broad economy.[56] Distinguishing this bubble's burst was the fact that, as opposed to historical bubble collapses of similar magnitude,[57] the centerpiece of this crisis was "not just another commodity but a building block of community and social life and a corner-stone of the economy: the family home."[58] As such, individuals impacted by the crisis suffered doubly, not only losing their investments but also having to face the possibility of becoming homeless.

II. REGULATORY BACKGROUND, NEW REGULATIONS, AND CONTROVERSIES

The securities markets are subject to significant levels of federal regulation, much of which centers on the SEC.[59] The Securities Exchange Act of 1934 endowed the SEC with broad powers to regulate securities.[60] In 1975, the SEC sanctioned Fitch, Standard & Poor's and Moody's as NRSROs and promulgated rules that certified ratings by those NRSROs as SEC-approved debt risk measures.[61] In short, the SEC chose to use those ratings created by the credit rating agencies as primary risk indicators for debt securities.[62] As a result, the influence of agency-created ratings very quickly expanded.[63] Later, to increase standardization and address negative public opinion surrounding credit rating agency accountability, in 2006, Congress passed the

54. *See id.*

55. *See id.*

56. *See id.* ("Pooling and other clever financial engineering did not provide investors with the promised protection.").

57. THE FIN. CRISIS INQUIRY COMM'N, *supra* note 2, at 4 (distinguishing the mortgage bubble from historical bubbles, such as "tulip bulbs in Holland in the 1600s, South Sea stocks in the 1700s, [and] Internet stocks in the late 1990s").

58. *Id.*

59. *The Laws that Govern the Securities Industry*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/about/laws.shtml#secexact1934 (last visited Jan. 26, 2015) (describing the various ways in which the SEC regulates securities markets).

60. *See id.*

61. *See* Lawrence J. White, *A Brief History of Credit Rating Agencies: How Financial Regulation Entrenched this Industry's Role in the Subprime Mortgage Debacle of 2007–2008*, 59 MERCATUS ON POL'Y, Oct. 2009, at 2; SEC Adopts Credit Rating Agency Reform Rules, *supra* note 6 ("NRSROs are credit rating agencies registered with the Commission under section 15E of the Exchange Act.").

62. *See* White, *supra* note 61, at 2.

63. *See id.*

Credit Rating Agency Reform Act,[64] which increased competition in the industry.[65] Later regulation, enacted after the financial crisis, encouraged ratings references to be removed from SEC rules.[66]

In response to the financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,[67] which endeavored to re-craft the American regulatory landscape in a multitude of places including, but by no means limited to, credit ratings.[68] This law imposed significant guidelines and parameters on entities within the financial industry.[69] Among other things, it established the Office of Credit Ratings within the SEC to monitor rating agencies.[70] Title IX, Subsection C of Dodd-Frank required the SEC Commissioners to promulgate and adopt NRSRO-related rules in various areas.[71] Rule 17g-5, at issue in this Recent Development, is a direct result of that portion of the Dodd-Frank Act.[72]

Rule 17g-5 was adopted on August 27, 2014,[73] becomes effective on June 15, 2015,[74] and stems from Dodd-Frank's May 2011 proposals

64. Credit Rating Agency Reform Act of 2006, Pub. L. No. 109-291, 120 Stat. 1327, 1327–29 (codified as amended at 15 U.S.C. 78a & 78o-7 (2012)); *see also* Yinping Xu & Charlie Xiao-chuan Weng, *Introduction and Suggestions on the Chinese Securities Credit Rating System from a Comparative Perspective*, 6 E. ASIA L. REV. 217, 231 (2011) (describing the passage of the Credit Rating Agency Reform Act).

65. *See* Marie Leone, *Bush Signs Rating Agency Reform Act*, CFO.COM (Oct. 2, 2006), http://ww2.cfo.com/banking-capital-markets/2006/10/bush-signs-rating-agency-reform-act.

66. *See* Removal of Certain References to Credit Ratings Under The Securities Exchange Act of 1934, Exchange Act Release No. 34-71194, 79 Fed. Reg. 1316, 1316 (Jan. 8, 2014); *The SEC's New 'Thought Crime,'* WALL ST. J. (Sept. 12, 2014), http://online.wsj.com/articles/the-secs-new-thought-crime-1410392798 ("In 2010 Dodd-Frank required the SEC to remove credit raters from its rules, but much of this work remains undone.").

67. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 5, 7, 12, 15, 22, 26, 28, 31, and 42 U.S.C.).

68. *See generally id.* (providing an overview of the Act's various sections).

69. *See generally id.* A number of secondary sources discuss this act. *See generally The Laws that Govern the Securities Industry*, *supra* note 59 (describing "consumer protection, trading restrictions . . . regulation of financial products, corporate governance and disclosure, and transparency" as additional regulated areas); Koba, *supra* note 36 (describing the Dodd-Frank Act in simple terms).

70. Koba, *supra* note 36.

71. Dodd-Frank Wall Street Reform and Consumer Protection Act, § 931, 124 Stat. at 1872; SEC Adopts Credit Rating Agency Reform Rules, *supra* note 6.

72. Dodd-Frank Wall Street Reform and Consumer Protection Act, § 931, 124 Stat. at 1872; Michael S. Piwowar, Comm'r, Sec. & Exch. Comm'n, Dissenting Statement at Open Meeting Regarding Final Rules on Nationally Recognized Statistical Rating Organizations (Aug. 27, 2014), [hereinafter Piwowar Dissenting Statement], *available at* http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370542770943#.VEvOAueT548.

73. *See* SEC Adopts Credit Rating Agency Reform Rules, *supra* note 6.

in Title IX, Subtitle C.[75] Specifically at issue is the second prong of the two-pronged addition of section (c)(8) of Rule 17g-5, which places vague restrictions on credit rating agency employee behavior:

> [A]n NRSRO is prohibited from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating, or developing or approving procedures or methodologies used for determining the credit rating, including qualitative and quantitative models, also: (1) [p]articipates in sales or marketing of a product or service of the NRSRO or a product or service of an affiliate of the NRSRO; or (2) *is influenced by sales or marketing considerations*.[76]

This Recent Development will focus on the ambiguity of the language prohibiting analysts from being influenced by sales and marketing considerations and the potential ramifications thereof. The SEC's basis and authority for adding this absolute prohibition lies in the Exchange Act of 1934's Section 15E(h)(3)(A), which imposes an affirmative obligation on the SEC Commissioners to "issue rules to prevent the sales and marketing considerations of an NRSRO from influencing the production of credit ratings by the NRSRO."[77] Thus, that portion of the Exchange Act is important because, without it, the SEC Commissioners would have never promulgated Rule 17g-5, section (c)(8).

The SEC Commissioners passed this rule, later published in the Federal Register on September 15, 2014,[78] by means of a 3-2 decision.[79] This rule's adoption took three years.[80] Leading up to the passage, various groups, especially consumer advocates, appraised the

74. Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 34–72936, 79 Fed. Reg. 55,077, 55,078 (Sept. 15, 2014) (to be codified at 17 C.F.R. pts. 232, 240, 249, 249b).

75. *See supra* note 71 and accompanying text.

76. Nationally Recognized Statistical Rating Organizations, 79 Fed. Reg. at 55,108 (emphasis added.

77. *Id.* at 55,107; *see* Kara M. Stein, Comm'r, Sec. & Exch. Comm'n, Statement at Open Meeting (Aug. 27, 2014) ("[Most of] [t]oday's rules . . . are specifically mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act.") [hereinafter Stein Statement].

78. Nationally Recognized Statistical Rating Organizations, 79 Fed. Reg. at 55,077.

79. *See* Andrew Ackerman, *SEC Approves Rules Aimed at Hidden Risk of Asset-Backed Securities*, WALL ST. J. (Aug. 27, 2014), http://www.wsj.com/articles/sec-votes-3-2-to-approve-rules-curbing-conflicts-at-credit-rating-firms-1409156894.

80. *See* Gretchen Morgensen, *The Stone Unturned: Credit Ratings*, N.Y. TIMES (Mar. 22, 2014), http://www.nytimes.com/2014/03/23/business/the-stone-unturned-credit-ratings.html ("When Dodd-Frank was enacted in July 2010, it directed the S.E.C. to issue rules regarding credit rating agencies within a year. The commission met the deadline, proposing rules in May 2011. Nearly three years later, they are still not final.").

proposed 2011 rules as not being strict enough.[81] It was potentially in response to such criticism that the SEC commissioners promulgated section (c)(8) using the broad language they ultimately chose.

All commissioners flagged issues with the rules enacted on August 27, 2014,[82] which demonstrates that no clear or correct answers to various included issues existed. A brief examination of these issues will further demonstrate what each of the five commissioners valued and will provide more insight into the resulting 3-2 decision. First, Commissioners Aguilar and Stein noted that conflicts of interest should be regulated further.[83] Second, Commissioner Aguilar flagged Dodd Frank-required look-back reviews, which are used, for example, in determining the existence of a conflict of interest, and argued that their regulation should be enhanced.[84] Third, Commissioners Stein and Piwowar were both dissatisfied with rating symbol consistency but disagreed as to whether they should be made more or less consistent.[85] Fourth, Commissioner Piwowar questioned the value of requiring

81. *See* Andrew Ackerman & Timothy W. Martin, *New Rules Near on Credit-Ratings Firms*, WALL ST. J. (Aug. 14, 2014), http://online.wsj.com/articles/new-rules-near-on-credit-ratings-firms-1408054946 (describing the SEC's earlier focus as being "on whether raters [were] following their own company guidelines around ratings methodology or conflict of interest").

82. *See supra* notes 71–74 and accompanying text.

83. *See* Luis A. Aguilar, Comm'r, Sec. & Exch. Comm'n, Restoring Integrity to the Credit Rating Process (Aug. 27, 2014), *available at* http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370542769492#.VCW9JeeT548 ("[W]hile the final rules' conflict of interest provisions are an important step in addressing the corrosive effects of the issuer-pays model, a more focused solution is necessary. The Commission should consider proposing rules that would more directly address the conflicts that arise when rating agencies are paid by the very issuers of the products they rate.") [hereinafter Aguilar Statement]; *see also* Stein Statement, *supra* note 77 ("As to the conflicts of interest section of today's rule, I believe it appropriately addresses the Commission's specific statutory mandate to issue rules to prevent sales and marketing from influencing the production of ratings. It is good as far as it goes, but our work is far from complete in getting at the fundamental conflicts of interest present in both the issuer-pay and subscriber-pay business models.").

84. *See* Aguilar Statement, *supra* note 83 ("[T]he Commission should consider prescribing the policies and procedures that would govern the look-back review required by Dodd-Frank. The rating agencies currently have discretion to develop these procedures themselves, and this may have led to predictable results.").

85. *See* Stein Statement, *supra* note 77 ("[F]urther work should be done to ensure that rating symbols are applied consistently. The failure of NRSROs to do this during the financial crisis has been well-established, and the results as we all know, were disastrous."). *But see* Piwowar Dissenting Statement, *supra* note 72 ("[T]he statute directs that the Commission require each NRSRO to have policies and procedures to apply rating symbols consistently for all instruments for which the symbol is used . . . I agree with the concern that credit ratings may be confusing and even downright misleading if they are not applied consistently. But academic research indicates that trying to achieve perfectly comparable rating scales is not only impractical – it is impossible.").

CEOs to sign a statement certifying their company's internal controls.[86] Fifth, both dissenting commissioners questioned increased burdens placed on company internal controls.[87] Taken together, it is evident that Commissioners Piwowar and Gallagher generally advocate for less stringent regulations, while Commissioners Stein, White, and Aguilar generally promote enhanced or additional regulation.

The segment of the new rules at issue in this Recent Development—Rule 17g-5(c)(8)[88]—is more specific. Commissioner Piwowar characterized the prohibition against "employee[s] involved in the ratings determination process from being 'influenced by' sales and marketing considerations" as setting "an impossible standard for compliance," with "no limiting principle."[89] According to his interpretation of the rules, a credit analyst would simply be unable to meet the high standard of completely avoiding sales and marketing influences that the rule's plain language requires. Commissioner Gallagher likewise flagged this restriction on "allowing sales and marketing concerns to influence the ratings process."[90] He criticized the Commission for failing to "tak[e] the time to issue a re-proposal" and characterized this "new catchall prohibition" as being tantamount to a "thoughtcrime."[91] Since a thought crime, on its own, is really a

86. *See* Piwowar Dissenting Statement, *supra* note 72 ("[P]ursuant to Exchange Act Section 15E(c)(3)(B)(iii), final Rule 17g-3(b)(2) requires that the chief executive officer (or a similar individual) of each NRSRO annually sign a statement regarding the effectiveness of the entity's internal control structure. These certifications will accomplish nothing other than to create potential personal liability.").

87. *See* Daniel M. Gallagher, Comm'r, Sec. & Exch. Comm'n, Dissenting Statement Concerning Adoption of Rules Implementing the Credit Risk Retention Provisions of the Dodd-Frank Act (Aug. 27, 2014) [hereinafter Gallagher Dissenting Statement], *available at* http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370542775101#.VEvOXOeT548 ("The added rule language also inappropriately places the focus on the *process* by which an NRSRO develops and maintains its internal control structure rather than the controls themselves. Worse, it signals—unintentionally, I expect—the possibility of a safe harbor."); Piwowar Dissenting Statement, *supra* note 72 ("[T]he rule the Commission is adopting that will require NRSROs to establish, maintain, enforce, and document an internal control structure . . . the rule being adopted lays out <u>twelve</u> specific, nonexclusive factors that NRSROs <u>must</u> 'consider' when establishing an internal control structure, another <u>three</u> that apply to the maintenance of the structure, and <u>two</u> that relate to enforcement of the structure. That is seventeen too many factors to actually create any true flexibility.").

88. Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 34–72936, 79 Fed. Reg. 55,077, 55,107–11 (Sept. 15, 2014) (to be codified at 17 C.F.R. pts. 232, 240, 249, 249b).

89. Piwowar Dissenting Statement, *supra* note 72.

90. Gallagher Dissenting Statement, *supra* note 87.

91. *Id.* ("This new prohibition is solely based on state of mind—there is no requirement that any action be taken. Even if the rating process is effectuated without any abuse, we could theoretically still pursue the analyst unfortunate enough to display evidence that a stray thought related to sales and marketing considerations crossed his or her mind.

reference to George Orwell's *Nineteen Eighty-Four*,[92] what Commissioner Gallagher almost certainly means is that the rule, as worded, could impermissibly criminally punish conduct that lacks the requisite mens rea. Commissioner Gallagher, then, would have likely been more satisfied with the rule if it had been written more narrowly or written so as to prohibit *affirmative* conduct, which would render the thought crime/mens rea issue moot.

Considering the three-year delay between the initially proposed rule and its August 2014 enactment, was the Commission facing a now-or-never situation, making it such that passing vague rules in 2014 would be preferable to passing no rules at all? While that notion could be a viable counterpoint to this Recent Development's criticism of this rule (and indeed a criticism of the rule in general), significant delays between statutes delegating authority to rulemaking bodies and the enactment of such rules are "not uncommon."[93] Thus, the delay between May 2011 and August 2014 should not be viewed as an obstacle to the implementation of any of the various recommendations described in this Recent Development or for which this Recent Development will advocate. Taking additional time to craft a more specific rule, then, would have been a viable option. The SEC Commissioners' failure to do so, however, has left the rule vulnerable to potential challenges.

III. POTENTIAL LEGAL CHALLENGES TO RULE 17G-5(C)(B)

These weaknesses in the rule leave it vulnerable to specific legal challenges, whereby the success of any challenge could result in the rule being deemed invalid. This Recent Development will discuss five potential legal weaknesses. The most common bases for overturning an administrative rule occur when an agency, in promulgating rules, has first exceeded its mandate or, second, failed to properly consider public comments.[94] Such challenges may or may not be applicable to Rule 17g-5(c)(8)'s validity. This Recent Development shall also analyze

Remember, the rating process, much less the rating itself, does not have to be influenced by such considerations to violate this new rule.").

92. *See id.* (citing GEORGE ORWELL, NINETEEN EIGHTY-FOUR (1949)).

93. Interview with Thomas Lee Hazen, Cary C. Boshamer Distinguished Professor of Law, Univ. of N. C. Sch. of Law, in Chapel Hill, N.C. (Sept. 25, 2014); *see also* DANIEL T. SHEDD & TODD GARVEY, CONG. RESEARCH SERV., R43710, A PRIMER ON THE REVIEWABILITY OF AGENCY DELAY AND ENFORCEMENT DISCRETION 2 (2014), *available at* http://fas.org/sgp/crs/misc/R43710.pdf ("The [Administrative Procedure Act of 1946] does not provide concrete time limits for agency action—instead, it leaves most deadlines for Congress to establish, if at all, in the particular agency's enabling statute.").

94. Interview with Thomas Lee Hazen, *supra* note 93.

whether this rule was arbitrary and capricious, thereby addressing a third possible reason for overturning an administrative rule by means of legal challenge on its face. In addition, it will analyze two potentially viable as-applied challenges as responses to possible enforcement actions taken pursuant to the rule. It is imperative to note that all five potential challenges would depend significantly on the factual circumstances of a particular case.[95]

Rule 17g-5(c)(8) is not the first contestable agency rule,[96] and one possible ground for challenging this rule is as an invalid exercise of rulemaking authority.[97] The test (deemed the "*Chevron* test"[98]) for a court's review of statutory construction by an agency involves two questions related to the level of congressional instruction and permissibility of agency construction.[99] When reviewing an agency rule under the *Chevron* test and in order to address the question of the rule's ambiguity, "[m]inor ambiguities or occasional imprecision in language may be brooked . . . so long as 'traditional tools of statutory construction' reveal Congress' intentions."[100] Analysis via the second step of the *Chevron* test should only occur "where the court confronts a gap in the statute that cannot be bridged by way of traditional tools of statutory construction."[101]

Applying the first portion of the *Chevron* test, Congress clearly provided the mandate to create this rule to the SEC in Exchange Act

95. *Id.*

96. *See, e.g.*, F.C.C. v. Fox Television Stations, Inc., 132 S. Ct. 2307, 2320 (2012) (holding that F.C.C. standards regarding "fleeting expletives and momentary nudity" were unconstitutionally vague as applied to certain Fox and ABC broadcasts); United States v. McGee, 763 F.3d 304, 316 (3d Cir. 2014) (holding that the SEC did not exceed its rulemaking authority in a challenge to Rule 10b5-2(b)(2) covering insider trading).

97. *See* Chevron, U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837, 843 n.9 (1984) ("The judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent.").

98. *See, e.g*,. Arizona Governing Comm. v. Norris, 463 U.S. 1073, 1109 (1983) (using the term "*Chevron* test").

99. *See Chevron*, 467 U.S. at 842–43 ("First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress . . . [But if a] court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute . . . [Instead, the court asks] whether the agency's answer is based on a permissible construction of the statute.").

100. Abbott Labs. v. Young, 920 F.2d 984, 994–95 (D.C. Cir. 1990) (Edwards, J., dissenting) (citing NLRB v. United Food & Commercial Workers Union, Local 23, 484 U.S. 112, 123 (1987)).

101. *Id.* (Edwards, J., dissenting).

Section 15E(h)(3)(A).[102] Conversely, however, Commissioner Piwowar explicitly stated that the SEC exceeded its rulemaking authority in promulgating this rule.[103] Even if a court were to move to the second prong—whether the rule is based on a permissible construction of the statute—it could go either way in determining permissible construction. This is because the court would not be permitted to simply impose its own statutory construction but would, under the *Chevron* test's second prong, instead, have to analyze whether the rule results from an allowable statutory construction.

On this scope of authority point, one potential argument for not overturning could be that the Exchange Act section 15E(h)(3)(A), which provides the mandate for making this rule, uses the term "influencing."[104] While the statute could be construed as granting a wide authority to the rulemaking body, it is important to note the distinction between the language of the statute and the language of the rule.[105] While the statute mandates creation of rules that "prevent the sales and marketing considerations . . . *from influencing*"[106] rating production, the ensuing rule prohibits analysts from being "*influenced by* sales and marketing considerations."[107] Thus, while the rule's language does generally comport with that of the statute in that both relate some version of the word "influence" to sales and marketing considerations, they are not exactly the same. The statute imposes a restriction on the sales and marketing considerations themselves, whereas the rule creates a prohibition on analysts. On balance, given the mandate's broad scope, the Commission's construction would likely be permissible. But due to the slight vagaries in wording evinced by the shift from active to passive voice, a court could determine that

102. *See* 15 U.S.C. § 78o-7(h)(3)(A) (2012) ("The Commission shall issue rules to prevent the sales and marketing considerations of a nationally recognized statistical rating organization from influencing the production of ratings by the nationally recognized statistical rating organization.").

103. *See* Piwowar Dissenting Statement, *supra* note 72 ("[T]he rules before us also reflect discretionary choices by a majority of the Commission that go well beyond the prescriptive Dodd-Frank mandates. These discretionary choices presume to make the rulemaking 'better' and 'tougher,' but there is no evidence that will be the case. Instead, they are simply unnecessary.").

104. Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 34–72936, 79 Fed. Reg. 55,077, 55,107 (Sept. 15, 2014) (to be codified at 17 C.F.R. pts. 232, 240, 249, 249b); *see* Piwowar Dissenting Statement, *supra* note 72.

105. *See generally* Maxine D. Goodman, *Reconstructing the Plain Language Rule of Statutory Construction: How and Why*, 65 MONT. L. REV. 229 (2004) (discussing the plain language rule of statutory construction).

106. 15 U.S.C. § 78o-7(h)(3)(A) (emphasis added).

107. Nationally Recognized Statistical Rating Organizations, 79 Fed. Reg. at 55,107–08 (emphasis added).

the regulation, worded as it is, exceeds the grant of authority. Overall, then, while a challenge to these rules under the *Chevron* test may be possible, it would be unlikely to succeed.

A second potential basis for declaring this rule invalid on its face could be on the ground that it was passed after not appropriately considering public comments. Commissioner Gallagher believed this rule "reflect[ed] the last-minute imposition of ill-conceived and hastily drafted rule provisions that upend[ed] the staff's efforts."[108] He believed that more time should have been devoted to the crafting and consideration of public comments related to Rule 17g-5(c)(8).[109] Absent a substantive review of every letter written regarding this rule, it is difficult to state whether the Commission got it right. However, analyzing a small sample of the most recently written letters—all those written since January 1, 2012—helps demonstrate the level of incorporation used. Of eight letters written in that period, three mentioned sales and marketing, and the Commission likely considered the comments and recommendations included in each letter.[110] It is worth noting, however, that absent a specific causal link between the letters and the Commissioners' consideration thereof, such a connection is somewhat conclusory. However, without testimony from each Commissioner affirming that she considered all public letters, such a link would be impossible to demonstrate. Thus, despite Commissioner Gallagher's opinion, it seems unlikely that a challenge to the consideration of public comments would succeed. A comparison of the numerous letters that mentioned sales and marketing considerations to that same language found in the final rule could defeat such a challenge.[111]

A third basis for declaring this rule legally invalid on its face would be if the "agency action . . . is 'arbitrary, capricious, an abuse of

108. Gallagher Dissenting Statement, *supra* note 87.

109. *See id.*

110. *See* Letter from Ams. for Fin. Reform to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n (Apr. 1, 2014), *available at* http://www.sec.gov/comments/s7-18-11/s71811-81.pdf; Letter from Micah Hauptman, Fin. Servs. Counsel, & Barbara Roper, Dir. of Investor Prot., Consumer Fed'n of Am., to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n 9 (Mar. 3, 2014), *available at* http://www.sec.gov/comments/s7-18-11/s71811-78.pdf; Letter from Jules Kroll, Chief Exec. Officer, & James Nadler, President, Kroll Bond Rating Agency, Inc., to Mary Jo White, Chair, Sec. & Exch. Comm'n (Aug. 19, 2014), *available at* http://www.sec.gov/comments/s7-18-11/s71811-88.pdf.

111. *See, e.g.*, Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 34–72936, 79 Fed. Reg. 55,077, 55,107 (Sept. 15, 2014) (to be codified at 17 C.F.R. pts. 232, 240, 249, 249b); *supra* note 109 and accompanying text.

discretion, or otherwise not in accordance with law.' "[112] In making such a determination, courts will examine whether the agency has analyzed all pertinent data and enunciated an appropriate reasoning for its decision, including tying relevant facts to steps taken.[113] If a court determines that the agency has clearly articulated such reasoning between fact finding and the action at issue, it will rule such action as *not* being arbitrary, capricious, or an abuse of discretion.[114] Loosely, "arbitrary" is defined as "founded on prejudice or preference rather than on reason or fact,"[115] while "capricious" means "contrary to the evidence or established rules of law."[116] Although these definitions are not perfect descriptions of what each term means in the context of 5 U.S.C. § 706 detailing "Scope of Review,"[117] understanding these terms in some detail is important.

In promulgating Rule 17g-5(c)(8), the Commission essentially used the language that Dodd-Frank mandated.[118] Even a biased observer would face an uphill battle in characterizing a prohibition on credit rating agencies "from issuing or maintaining a credit rating where a person within the NRSRO who participates in determining or monitoring the credit rating . . . is influenced by sales or marketing considerations"[119] as being founded on preference or prejudice (arbitrary) or contrary to established rules or evidence (capricious). Thus, while worth highlighting, a challenge to this rule, as it currently stands, on the basis that it is arbitrary and capricious would be unlikely to succeed because the prohibition under the rule meets neither of those definitions. The lack of a concrete factual scenario that would give rise to a challenge at this stage of the rule's existence only underscores that outcome.

112. Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (quoting 5 U.S.C. § 706 (2012)).

113. *Id.* (quoting Motor Vehicle Mfrs. Ass'n of the U.S. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983)).

114. *Id.*

115. BLACK'S LAW DICTIONARY (10th ed. 2014).

116. BLACK'S LAW DICTIONARY (10th ed. 2014).

117. 5 U.S.C. § 706 (2012).

118. *Compare* 15 U.S.C. § 78o-7 (2012) (mandating rules that "prevent the sales and marketing considerations . . . from influencing" rating production), *with* Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 34–72936, 79 Fed. Reg. 55,077, 55,107–08 (Sept. 15, 2014) (to be codified at 17 C.F.R. pts. 232, 240, 249, 249b) (promulgating a rule preventing analysts from being "influenced by sales and marketing considerations").

119. Nationally Recognized Statistical Rating Organizations, 79 Fed. Reg. at 55,108.

Two additional as-applied[120] challenges exist as rebuttals to potential criminal enforcement actions taken under this rule. Specifically, Rule 17g-5(c)(8) is vulnerable to attack as being either an unlawful prohibition against thought crimes or vague to the extent that it should be deemed void. These two challenges would be best employed as *responses* to enforcement actions taken against some credit analyst or credit rating agency for ostensibly violating this rule. Thus, the ensuing two challenges would be difficult—if not impossible—to raise without the SEC bringing some initial enforcement action. First is a potential challenge on the basis that the conduct prohibited by Rule 17g-5(c)(8) is tantamount to prohibiting a thought crime—criminally punishing activity in the absence of mens rea—and is thus invalid.[121] Commissioner Gallagher, in his dissent, espoused such a view.[122] In the context of thought crimes, commentators have further analogized this rule to prohibiting journalists from choosing to write stories about which advertisers may have strong feelings or prosecuting traders for insider trading because they have alleged "ill intent."[123] Thus, to prosecute a credit analyst for giving a company a rating that may later be deemed inappropriate due to that credit analyst's having been influenced by the rated company's sales and marketing considerations would likewise equate to prosecuting individuals who lacked the required mens rea.

A claim that this rule is invalid because it unlawfully prohibits thought crimes could have some merit, but it is one that would depend significantly on the type of action brought and the facts of a particular case. As a hypothetical, suppose a Moody's analyst gave a company's credit a favorable rating based on objectively valid information. Later, that company's credit faltered, and at the same time, it comes to light that the analyst had been exposed to some minor level of that subject company's sales and marketing materials. Read plainly, the rule would punish the analyst's behavior by presupposing mens rea, but significant additional fact-finding would be required in order to

120. Richard H. Fallon, Jr., *As-Applied and Facial Challenges and Third-Party Standing*, 113 HARV. L. REV. 1321, 1321 (2000) (describing an as-applied challenge as a situation "in which a party argues that a statute cannot be applied to her because its application would violate her personal constitutional rights"); *see* Cristina D. Lockwood, *Defining Indefiniteness: Suggested Revisions to the Void for Vagueness Doctrine*, 8 CARDOZO PUB. L. POL'Y & ETHICS J. 255, 290 (2010) (citing City of Chicago v. Morales, 527 U.S. 41, 82 (1998)).

121. *See* Gallagher Dissenting Statement, *supra* note 87 (noting that "a majority of the Commission has taken the novel approach of establishing what amounts to a thoughtcrime").

122. *See id.*

123. *See* Gallagher Dissenting Statement, *supra* note 87; *The SEC's New 'Thought Crime,'* *supra* note 66.

determine the degree to which the sales and marketing considerations, in combination with other factors, affected the analyst's calculus and, in turn, produced the final rating. Analysis beyond setting up the theoretical framework is not possible absent factual grounding. This is so because if there is no behavior or factual situation to examine, it is impossible to determine a hypothetical actor's true state of mind.

Finally, the rule could be challenged as void for vagueness. The Constitution mandates that laws that prohibit criminal behavior definitely and explicitly explain the punishable conduct.[124] In the alternative, if a legislature delegates authority to administrators and/or judges to the extent that such delegation is so extensive that it would lead to arbitrary prosecutions, a court may determine that a rule is void for vagueness.[125] Even if a specific statute is worded so broadly as to potentially be void for vagueness, a subsequent "narrowing, authoritative interpretation,"[126] may suffice to ward off a void-for-vagueness-based challenge to the rule. As described in *Kolender v. Lawson*,[127] standing alone, a statute is *not* void for vagueness and *does* satisfy due process by satisfying two requirements. First, it must explicitly define the criminal act to the extent that an ordinary person would comprehend what particular conduct the law prohibits.[128] Second, it must explicitly define the criminal act so that it "does not encourage arbitrary and discriminatory enforcement."[129] The Supreme Court has endorsed the *Kolender* standard, which has been re-articulated in the more recent case *Skilling v. United States*.[130]

Depending on the facts, a challenge to this rule based on a claim that it is void for vagueness could succeed under the standard outlined in *Kolender* and reiterated in *Skilling*.[131] This rule's enforcement in the criminal context *could* be considered arbitrary to the extent that the

124. *See* United States v. Harriss, 347 U.S. 612, 617 (1934) ("The constitutional requirement of definiteness is violated by a criminal statute that fails to give a person of ordinary intelligence fair notice that his contemplated conduct is forbidden by the statute. The underlying principle is that no man shall be held criminally responsible for conduct which he could not reasonably understand to be proscribed."); *see also Vagueness Doctrine*, CORNELL U. LEGAL INFO. INST., http://www.law.cornell.edu/wex/vagueness _doctrine (last visited Jan. 30, 2015) ("Criminal laws that violate this requirement are said to be void for vagueness. Vagueness doctrine rests on the due process clauses of the Fifth and Fourteenth Amendments of the U.S. Constitution.").

125. *See Harris*, 347 U.S. at 617.

126. Dirks v. SEC, 802 F.2d 1468, 1471 (D.C. Cir. 1986) (citing Hoffman Estates v. Flipside, 455 U.S. 489, 497 (1982)).

127. Kolender v. Lawson, 461 U.S. 352 (1983).

128. *Id.* at 357.

129. *Id.*

130. *See* Skilling v. United States, 561 U.S. 358, 364 (2010).

131. *See id.*

rule should be declared void. That is, one could challenge Rule 17g-5(c)(8) as void for vagueness in that it does not definitely and explicitly explain the criminal conduct.[132] More specifically, the prohibited conduct is being "influenced by sales and marketing considerations."[133] One could argue that such behavior is not conduct at all. Of course, the SEC could take the opposing position and claim that the conduct was the mere exposure to sales and marketing considerations. As with a potential challenge to the statute based on it criminalizing thought crimes, a challenge to the rule based on it being void for vagueness *may* have to arise in the as-applied context. Whether a *facial* void-for-vagueness challenge, which would not depend on particular factual circumstances, would succeed is an unanswered question and a situation governed by two competing lines of cases.[134] A facial challenge, if permitted, would most likely result in the aforementioned arguments, with the SEC arguing that the rule is *not* void and the challenger arguing that the rule does prohibit behavior that is too broad to accurately define. It is dispositive to note that, in general, void for vagueness claims in the context of the SEC have failed.[135]

Overall, while some legal challenges to this rule have merit, no specific legal challenge to this rule would guarantee a challenger's success. Facial challenges of it as an invalid exercise of rulemaking authority, for failure to consider public comments, or as being arbitrary and capricious would be almost certainly fail to satisfy the somewhat stringent elements required in order to declare a rule invalid by virtue of those respective doctrines. Considering that Rule 17g-5(c)(8) has not yet gone into effect,[136] as-applied challenges to the rule for its being void for vagueness or an unlawful prohibition against

132. *See Kolender*, 461 U.S. at 357; *Vagueness Doctrine*, *supra* note 124.

133. Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 34–72936, 79 Fed. Reg. 55,077, 55,108 (Sept. 15, 2014) (to be codified at 17 C.F.R. pts. 232, 240, 249, 249b).

134. *See* Lockwood, *supra* note 120, at 292 ("[T]here are two groups of cases. There is the National Dairy line of cases requiring that, except where the challenged law involves First Amendment rights, the litigant must prove that the law is unconstitutionally vague in all of its applications. Such a test requires that the litigant survive an 'as-applied' challenge before he can proceed with an argument that the law is void for vagueness on its face in its entirety. Then there is another group of cases, where the Court, albeit for various reasons, reviews a law on its face even though the law does not implicate First Amendment rights. All that can be stated with certainty is that the Court does not have a consistent position on facial review in void for vagueness cases, creating uncertainty within the doctrine.").

135. *See, e.g.*, Dirks v. SEC, 802 F.2d 1468, 1470 (D.C. Cir. 1986) ("We conclude that Dirks' void-for-vagueness argument is without merit. Although emphasizing the breadth of the statutory language, Dirks recognizes, as he must, that the SEC in 1976 placed a narrowing gloss on the provision.").

136. *See supra* note 74 and accompanying text.

thought crimes are currently impossible. After it becomes effective, the rule could have a slightly better chance of being declared invalid by virtue of one of these doctrines as compared with the relevant facial challenges. However, such an outcome would depend highly on the factual scenario at the time, and even then, a challenger would have difficulty overcoming the skepticism and high standards of either claim. Despite the reality of Rule 17g-5(c)(8)'s likely resilience to legal challenges, more general aspects of this rule may prove to be problematic.

SECTION IV. NONLEGAL, POLICY-FOCUSED RAMIFICATIONS OF RULE 17G-5(C)(8)

Beyond potential legal challenges, Rule 17g-5(c)(8) presents numerous undeniable, negative ramifications that will complicate its enforcement. The rule's interaction with other regulations may provide loopholes to compliance, and questions remain as to whether the August 27 rules were even necessary, due to the existence of other similar safeguards. If left in its current form, Rule 17g-5(c)(8) could implicitly sanction unclear regulatory language and influence the wording of future rules. Finally, the rule's passive phrasing and structure could undermine its effectiveness and overall usefulness.

First, this rule has produced an unclear regulatory framework whereby the SEC has the ability to prosecute at will. Larger firms could experience a chilling effect where credit analysts become hesitant to give ratings due to uncertainty about what is permissible. If a credit analyst believes that minimal exposure to a to-be-rated company's promotional materials constitutes an influence, then that analyst would be hesitant to risk SEC prosecution by rating that company. Due to the proliferation of advertising and frequency of Internet, television, in-person, and other interactions with corporate promotions, the number of companies whose credit that any individual analyst may be willing to rate could diminish. Agencies may have to hire additional analysts to fill in the gaps and account for monitoring costs. These increased overhead expenses may then be passed on to end-consumers purchasing these ratings. Such increased costs could be very problematic as well, considering that, independently, the cost of obtaining a credit rating has increased significantly in recent years.[137] Furthermore, the industry's oligarchical nature combined with the fact

137. *See* Zeke Faux, *Credit Rating Fees Rise Faster than Inflation as Governments Downgraded*, BLOOMBERG (Nov. 15, 2011), http://www.bloomberg.com/news/2011-11-15/credit-rating-fees-rise-faster-than-inflation-as-governments-fret-expenses.html.

that many debt instruments require multiple ratings leave ratings purchasers with little leverage to prevent the credit rating agencies from passing on any increased monitoring costs.[138]

Second, the fact that smaller NRSROs are exempted from having to comply with this rule as permitted by Exchange Act section 15E(h)(3)(B)(i)[139] could result in larger firms breaking up into smaller legal entities while remaining functionally similar. The industry is very concentrated, and as of December 2013, only ten entities were designated as NRSROs.[140] Ratings by Moody's, Standard & Poor's, and Fitch together constituted 96.5% of all outstanding ratings,[141] while these same three firms employed 90.8% of all credit rating analysts.[142] Because the Commission inserted this safe harbor,[143] larger players will be incentivized to downsize. If they become smaller, they may be able to avail themselves of the safe harbor, thereby falling outside the purview of more restrictive rules. While it is doubtful that Moody's will break up, the SEC has placed an onerous burden on credit analysts while also providing an escape hatch that would allow credit rating agencies to avoid subjecting themselves to that burden by changing their structure. This safe harbor is necessary,[144] but drawing the line may become problematic. Larger firms may pressure the SEC to be treated like smaller firms, especially if the SEC begins treating every

138. *See id.*

139. Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 34–7293679, Fed. Reg. 55,077, 55,111 (Sept. 15, 2014) ("Section 15E(h)(3)(B)(i) of the Exchange Act requires that the Commission's rules under section 15(h)(3)(A) shall provide for exceptions for small NRSROs with respect to which the Commission determines that the separation of the production of credit ratings and sales and marketing activities is not appropriate. To implement this provision, the commission proposed to amend Rule 17g-5 by adding paragraph (f). As proposed, paragraph (f) would provide a mechanism for a small NRSRO to apply in writing for an exemption from the absolute prohibition that would be established by adding paragraph (c)(8) to Rule 17g-5.") (to be codified at 17 C.F.R. pts. 232, 240, 249, 249b).

140. *See* U.S. SEC. & EXCH. COMM'N, ANNUAL REPORT ON NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS 6 (Dec. 2013), *available at* http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep1213.pdf.

141. *See id.* at 8.

142. *See id.* at 14.

143. *See* Nationally Recognized Statistical Rating Organizations, 79 Fed. Reg. at 55,112 ("Under the final amendment, exemptions will be granted on a case-by-case basis, after analyzing the facts and circumstances the applying NRSRO presents in its request for relief and any other relevant facts and circumstances. Any exemptive relief granted can be tailored to the specific circumstances of the NRSRO and can include specific terms and conditions designed to mitigate the sales and marketing conflict and help ensure that any relief that may be provided to a small NRSRO does not undermine the overarching purpose of section of 15E(h)(3)(A) of the Exchange Act.").

144. *See id.* at 55,111–12 (discussing reasons for exempting smaller NRSROs from the more stringent sales-and-marketing-related restrictions imposed on larger NRSROs).

credit rating agency except the "Big Three"[145] as falling within the exemption. Overall, then, the larger credit rating agencies *could* come to a point when they react drastically to the potential liability they could face if one of their analysts was influenced by sales or marketing considerations by downsizing or breaking up.

Third is the question of whether this rule will actually change behavior and whether it even needs to do so at this time due to the existence of complementary protections. Commissioner Piwowar, referring to previously sanctioned protections, including but not limited to the Credit Rating Agency Reform Act of 2006 and Exchange Act Release No. 55857, dealing with the Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, "see[s] little reason to adopt further restrictions on credit rating agencies' sales and marketing activities at this time given the multitude of protections already in place."[146] This broad rule could heighten anxiety while not causing any real behavioral changes. Whether credit rating agencies have adopted protections to the extent that this rule is unnecessary is debatable,[147] but the criticism is worth considering. Relatedly, it is unknown whether the SEC will even bring enforcement actions for violations of this rule; the very broad language could make enforcement difficult and costly. While silent as to the August 27 rulemaking activity due to its July 2014 release, one report estimates that the Securities and Exchange Commission's spending from 2014 to 2015 will increase 19.1%,[148] significantly higher than the estimated spending jump of 11% for general business regulatory spending.[149]

Fourth, Rule 17g-5(c)(8) could create a norm in SEC rulemaking that, left unchecked, could be applied to other scenarios, such as insider trading. Commissioner Gallagher warned about such a

145. Alessi, Wolverson, & Sergie, *supra* note 31.

146. Piwowar Dissenting Statement, *supra* note 72.

147. *Compare id.* (describing the significance of other reforms, including "Amendments to Rules for Nationally Recognized Statistical Rating Organizations . . . Amendments to Rules for Nationally Recognized Statistical Rating Organizations . . . [and] Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act"), *with* Aguilar Statement, *supra* note 83 ("The centerpiece of these changes is a pair of complementary prohibitions that will better insulate the ratings process from sales and marketing considerations. This is vital, for conflicts of interest represent the most serious threat to the accuracy and reliability of credit ratings.").

148. SUSAN DUDLEY & MELINDA WARREN, ECONOMIC FORMS OF REGULATION ON THE RISE: AN ANALYSIS OF THE U.S. BUDGET FOR FISCAL YEARS 2014 AND 2015, at 17 (2014), *available at* https://wc.wustl.edu/files/wc/imce/2015_regulators_budget_1.pdf.

149. *See id.*

situation.[150] If a rule prohibiting credit analysts from being influenced by sales and marketing considerations is allowed to stand, it may become easier for the SEC to impose some other categorically broad externality on traders for purposes of determining whether they have engaged in insider trading. Given the more high-profile nature[151] and greater frequency of insider-trading prosecutions—nearly one per week in 2013[152]—the SEC could use this similar passive language to simplify insider-trading prosecution by increasing the range of activity that could constitute impermissible insider trading. Such an outcome, then, could subject additional regulated professionals to similarly impossible-to-meet standards.

Fifth and finally, the passivity of the phrase, "is influenced by sales and marketing considerations,"[153] could remove some of the rule's strength. Earlier promulgations of the rule prohibited actors from affirmatively "participating in" sales and marketing activities.[154] Such a formulation is clearer and sensibly penalizes affirmative behavior that would require or at least involve a presumption of intent. Under the current language, enforcing a violation of passive behavior could make it more difficult for the SEC to causally link an analyst's recommendation to sales and marketing considerations. Overall, then, Rule 17g-5 presents numerous problems that will unfold regardless of whether the rule itself is challenged. Despite the rule's problems, the SEC Commissioners could mitigate its ill effects by issuing a simple clarifying statement.

V. VARIOUS ALTERNATIVES AND SOLUTION

Time will tell which legal and nonlegal ramifications will manifest, but in the interim, the SEC Commissioners and other actors can work to accomplish the Dodd-Frank's goals. Various short-term solutions include proposing new language, repealing Rule 17g-5(c)(8), or issuing a formal clarifying statement. Longer-term options include altering the

150. *See* Gallagher Dissenting Statement, *supra* note 87.

151. *See, e.g.*, Melvin Backman, *Five Famous Insider Trading Cases*, CNNMONEY (June 2, 2014), http://money.cnn.com/gallery/investing/2014/06/02/insider-trading-famous-cases/index.html (describing five high-profile insider-trading prosecutions).

152. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA FISCAL, 2013, at 3 (2013), *available at* http://www.sec.gov/about/secstats2013.pdf (noting that the SEC brought forty-three insider-trading-related enforcement actions in 2013).

153. Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 34–72936, 79 Fed. Reg. 55,077, 55,108 (Sept. 15, 2014) (to be codified at 17 C.F.R. pts. 232, 240, 249, 249b).

154. *See* Letter from Michel Madelain, President & Chief Operating Officer, Moody's Investors Serv., to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n 2 (Aug. 8, 2011), *available at* http://www.sec.gov/comments/s7-18-11/s71811.shtml.

governance structure of credit rating agencies or imposing civil liability on credit rating agencies. Many viable solutions exist; this Part will briefly outline the various short-term and long-term options before recommending one simple, pragmatic solution: SEC Commissioners should issue a formal clarifying statement that provides further guidance as to Rule 17g-5(c)(8)'s scope and applicability.

First, the SEC could propose new language that is clearer than Rule 17g-5(c)(8)'s current language. Commissioner Gallagher would support this, as he advocates for "issu[ing] a re-proposal."[155] Such new language could take many different forms, but the language could be altered from punishing passive activity to punishing affirmative acts.

Second, the Commission could repeal this rule. Commissioner Piwowar's dissenting statement notes that there are already a "multitude of regulations in place" dealing with sales and marketing considerations, thereby making this rule unnecessary.[156] Given that a majority of Commissioners do support this rule,[157] it is unlikely that such a repeal would occur soon. However, in June 2015, the term of Commissioner Aguilar,[158] who supported this rule, will end.[159] It is possible that the new appointee may be more willing to question this rule and, thus, increase the chances of a complete repeal. That being said, the new appointee would, like Commissioner Aguilar, be a Democratic appointee,[160] so a significant change in opinion—and thus the likelihood of a repeal succeeding—remains low compared to the viability of other solutions.

Third, the SEC could publish a statement clarifying the meaning and scope of this rule. Doing so would directly remove the ambiguity associated with the influenced by sales and marketing language in Rule

155. Gallagher Dissenting Statement, *supra* note 87.

156. Piwowar Dissenting Statement, *supra* note 72.

157. *See supra* note 79 and accompanying text.

158. *See* Aguilar Statement, *supra* note 83.

159. *See Current SEC Commissioners*, U.S. SEC. & EXCHANGE COMMISSION http://www.sec.gov/about/commissioner.shtml#.VEudf-eT548 (last modified Sept. 17, 2013).

160. Sean Forbes, *Borzi Plays 'Three Questions with Critics of DOL's Expected Fiduciary Rule Re-Proposal*, *Pension and Benefits Blog*, BLOOMBERG BNA (Mar. 19, 2014), http://www.bna.com/borzi-plays-three-b17179886023/ (explaining that Chair White is a Democrat); Sarah N. Lynch, *SEC Swears in New Democratic Commissioner Kara Stein*, REUTERS (Aug. 9, 2013), http://www.reuters.com/article/2013/08/09/us-sec-stein-idUSBRE9780WV20130809 (explaining that Commissioners Piwowar and Stein are a Republican and a Democrat, respectively); Benjamin Snyder, *Stiglitz Barred from SEC Panel on High-Frequency Trading*, FORTUNE (Jan. 5, 2015), http://fortune.com/2015/01/05/stiglitz-reportedly-barred-from-sec-panel/ (clarifying that Commissioners Gallagher and Aguilar are a Republican and a Democrat, respectively).

17g-5(c)(8) and, indeed, is well within the SEC's purview; "while agency interpretations that lack the force of law do not warrant deference when they interpret ambiguous *statutes,* they do normally warrant deference when they interpret ambiguous *regulations.*"[161] Thus, if the SEC Commissioners were to issue a clarifying interpretation of this ambiguous regulation, courts would defer to the meaning of that clarifying statement, thereby giving it substantial authority. At a minimum, the Commission could switch the language from the passive to the active voice and clarify that "sales and marketing" refers to sales and marketing *that directly result in an impact on ratings by means of specific cash or gift outlays by companies being rated and that are directed toward the members of the analyst team creating the rating*. This clarification will specify what behavior is punishable while still furthering Dodd-Frank's purposes. In so doing, it will turn an unclear regulatory framework into a clear regulatory framework, dampening any possible chilling effects of the rule by allowing analysts and other actors to operate within the framework's confines without worrying about receiving unexpected negative SEC attention. Depending on the clarifying statement's scope, large firms would no longer be incentivized to potentially downsize in order to avoid having to comply with the vague rule. As such, possible organizational disruption will be avoided. Clarifying this rule may also help the SEC, which, facing shrinking enforcement budgets, may lack the resources to ensure serious consideration of such a vaguely worded rule. Clarifying the statement to the active voice would also prevent the SEC from establishing an organizational norm of couching broad, catchall restrictions in the passive voice. Finally, without such clarification, the SEC could attempt to enforce the rule under even the most causally remote circumstances.

Numerous long-term solutions exist that could either work in conjunction with or substitute their authority for those solutions promulgated by this rule. First, credit rating agencies could become governmentally or pseudogovernmentally run and engage in a completely blind rating process.[162] This solution could supersede Rule 17g-5(c)(8)'s language altogether and fundamentally change the credit rating industry. It would also lessen the significance of sales and marketing considerations: if the ratings process is blind, analysts, at least theoretically, should be immune to such influences. While such a

161. Am. Fed'n of State, Cnty. & Mun. Emps. v. Am. Int'l Grp., Inc., 462 F.3d 121, 126 (2d Cir. 2006) (citing Christensen v. Harris Cnty., 529 U.S. 576, 588 (2000)).

162. Voorhees, *supra* note 12, at 888.

scenario is unlikely to happen in the current political climate, one more major financial crisis tied to unsteady credit ratings could move public opinion toward such a solution.

As for a second long-term solution, an "International Oversight and Accountability Board" could be created.[163] Such an internationally respected organization would assist investors and NRSROs as they operate in diverse and often conflicting regulatory environments by promulgating "best practices" and facilitating the dissemination of material information.[164] However, funding control over the board could be problematic, and buy-in from countries with well-established regulatory schemes could prove difficult to obtain.[165] Third, barriers to entry for joining the industry could be lowered, thereby breaking the industry's highly concentrated nature.[166] While many examples of such barriers are present, issuer reliance on ratings by Standard & Poor's and Moody's is especially difficult for potential new entrants to surmount.[167] If the credit rating industry becomes more competitive, the dominant agencies will lose some of the power that helped exacerbate many of the problems in the mid-2000s. Fourth, to completely alter the risk-reward situation that credit rating agencies face, civil liability could be imposed for inaccurate ratings.[168]

Finally, self-regulation, fostered by the SEC, could serve to increase agency accountability.[169] Precedent exists for such action, as

163. *Id.* at 887 (noting that such an oversight board was supported by the Securities Industry and Financial Markets Association's Credit Rating Agency Task Force).

164. *Id.* at 887–88.

165. *Id.* at 888 (explaining that, if an International Oversight and Accountability Board were created, "the U.S. would probably insist that it retain special authority over the Big Three, all of which are headquartered within its jurisdiction").

166. *See* Erin M. Wessendorf, *Regulating the Credit Rating Agencies*, 3 ENTREPRENEURIAL BUS. L.J. 155, 158–59 (2008).

167. *See id.* at 171 ("A large barrier to entry comes with new applicants vying for the business of issuers who solely rely on the ratings of Moody's and S&P. The majority of investors have name recognition with these two large market participants which many of the smaller market players will simply not have. No name recognition leads to a lack of reputation which can in turn lead to little trust from the investors whom the issuers desire to buy their securities and investments. While an extreme drop of investor confidence in the ratings system currently might help the newer credit rating outfits, it is up to the SEC to allow market entrants a regulated path to entry, instead of stifling the competition along the way.").

168. *See* Nan S. Ellis, Lisa M. Fairchild & Frank D'Souza, *Is Imposing Liability on Credit Rating Agencies a Good Idea?: Credit Rating Agency Reform in the Aftermath of the Global Financial Crisis*, 17 STAN. J.L. BUS. & FIN. 175, 222 (2012) (debating standard to apply—intentional, negligence, or strict liability—if imposing civil liability for inaccurate ratings and determining that negligence standard would be most appropriate).

169. *See* Caitlin M. Mulligan, *From AAA to F: How the Credit Rating Agencies Failed America and What Can Be Done to Protect Investors*, 50 B.C. L. REV. 1275, 1275 (2009)

the SEC has granted self-regulatory powers to other actors whose regulation falls under its purview, such as FINRA.[170] If the credit rating agencies began to regulate themselves, they could craft more efficient and prudent solutions that allow them to continue operating while ensuring they do not lose the privilege of self-regulation. Although these short- and long-term solutions are all, to some extent, viable, the simplest and most effective way to address the rule's ambiguity problem would be for the SEC Commissioners to issue a formal statement that clarifies the scope of behavior covered by Rule 17g-5(c)(8).

An independently published statement by the SEC Commissioners regarding Rule 17g-5(c)(8) would directly and definitively clarify the agency's position on the rule and its boundaries. Doing so could quash any potential void-for-vagueness issues that may arise in the future, thereby stifling one of the more viable legal challenges to this Rule. Such clarification, then, could conform to requirements that make a law vague or not vague.[171] Relatedly, the Commission could add a definition, noting detailed examples of what would constitute a credit analyst's being "influenced by sales and marketing activities." Such a solution is preferable to a full repeal and reproposal, as it would serve to clarify the language without offending commenters who pushed for the "influenced by" language.[172] A clarifying statement could allow the passive statement to stand while enunciating a narrower standard for

("[T]he SEC should seek to ensure the transparency and integrity of the markets by facilitating, through regulatory requirements, the formation of a self-regulatory organization with oversight of and responsibility for credit rating agencies.").

170. *See BrokerCheck Glossary*, FINRA, http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/P015176 (last updated June 21, 2014) (defining a Self-Regulatory Organization (SRO) as "[a]n entity, such as FINRA, responsible for regulating its members by adopting and enforcing rules that govern its members' business conduct").

171. *See* Grayned v. City of Rockford, 408 U.S. 104, 108-09 (1972) ("Vague laws offend several important values. First, because we assume that man is free to steer between lawful and unlawful conduct, we insist that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly. Vague laws may trap the innocent by not providing fair warning. Second, if arbitrary and discriminatory enforcement is to be prevented, laws must provide explicit standards for those who apply them. A vague law impermissibly delegates basic policy matters to policemen, judges, and juries for resolution on an ad hoc and subjective basis, with the attendant dangers of arbitrary and discriminatory application. Third, but related, where a vague statute 'abut(s) upon sensitive areas of basic First Amendment freedoms,' it 'operates to inhibit the exercise of (those) freedoms.' ").

172. *See, e.g.*, Letter from Ams. for Fin. Reform, *supra* note 110 (criticizing the rule initially proposed as "inappropriately narrow in that it only addresses the direct involvement of marketing and sales personnel in ratings decisions. This approach disregards the many ways in which sales and marketing considerations can pervade and distort the ratings process").

what activity shall be deemed to have been "influenced by" considerations tied to sales and marketing. Therefore, the SEC Commissioners' issuing of a clarifying statement would be the means by which to resolve Rule 17g-5(c)(8)'s ambiguity.

Some critics could flag the possibility that a clarifying statement may cause more confusion and uncertainty by implicitly creating a line of what is or is not considered influenced by sales and marketing considerations where such a line may not be appropriate. While that outcome is possible, additional guidance would open the door to further commentary that could be used to craft even clearer guidance. At a minimum, then, issuing a formal clarifying statement can only further the Dodd-Frank Act's purposes by clarifying the spectrum of offensive behavior.

CONCLUSION

While this rule is necessary and ultimately a natural, organic outcropping of the Dodd-Frank Act, it presents problems in its current form. In the short run, it will yield an unclear regulatory climate and result in wide SEC prosecutorial discretion. Its long-term consequences are less clear and will depend on the SEC's use of this rule in the short run. What is certain is that, left as is, this rule is unlikely to serve as a uniting vehicle that furthers the objectives of Dodd-Frank and will instead place unnecessary weight on regulators and credit analysts alike.

This Recent Development would also like to point out that some observers may question how important analysis of this rule is at this point. After all, it has only recently been enacted and has not, as of the writing of this Recent Development, come into effect and therefore has not been the basis of an enforcement action. The SEC is a large organization, and with over 4,000 employees,[173] this rule's language could also confuse SEC enforcers. The rule's plain language seems to provide broad enforcement capabilities, but absent additional clarification, who will guide such enforcement? A clarification would result in less waste and more focused enforcement. Furthermore, a wait-and-see approach seems irresponsible when clarification would involve significant but by no means overwhelming analysis and a simple press release. Failure to act also signals confusion and dissention on the part of the SEC Commissioners.

173. U.S. SEC. & EXCH. COMM'N, FY 2014 CONGRESSIONAL BUDGET JUSTIFICATION 14 (2013), *available at* http://www.sec.gov/about/reports/secfy14congbudgjust.pdf.

Though Rule 17g-5(c)(8), in its current form, has not been enacted as of the writing of this Recent Development, when it does go into effect, the ball will be in the SEC's court to either begin enforcing this rule, which itself could yield any number of challenges, or issue a simple statement clarifying this rule. Absent short-term enforcement or clarification, the rule's ambiguity will increase in magnitude, leading to greater uncertainty precedent to potential longer-term enforcement actions. While the SEC has many courses of action at its disposal, its optimal path would be to issue a statement clarifying this ambiguity. Issuing a clarifying statement will help both credit analysts and SEC enforcers by establishing a line of what behavior will and will not be permitted while simultaneously avoiding a major reversal or admission of error by maintaining the rule's language in its current structural form.

KYLE R. CUNNION[**]

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