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SECURITIES AND EXCHANGE COMMISSION
Release No. 34-66514

March 5, 2012

Order Granting Temporary Exemption of Morningstar Credit Ratings, LLC from the Conflict of Interest Prohibition in Rule 17g-5(c)(1) of the Securities Exchange Act of 1934

I. Introduction

Rule 17g-5(c)(1) of the Securities Exchange Act of 1934 (“Exchange Act”) prohibits a nationally recognized statistical rating organization (“NRSRO”) from issuing or maintaining a credit rating solicited by a person that, in the most recently ended fiscal year, provided the NRSRO with net revenue equaling or exceeding 10% of the total net revenue of the NRSRO for the fiscal year. In adopting this rule, the Commission stated that such a person would be in a position to exercise substantial influence on the NRSRO, which in turn would make it difficult for the NRSRO to remain impartial.¹

II. Application and Exemption Request of Morningstar Credit Ratings, LLC

Morningstar Credit Ratings, LLC (“Morningstar”), formerly known as Realpoint LLC (“Realpoint”), is a credit rating agency registered with the Commission as an NRSRO under Section 15E of the Exchange Act for the classes of credit ratings described in clauses (i) through (v) of Section 3(a)(62)(B) of the Exchange Act. Morningstar traditionally has operated mainly under the “subscriber-paid” business model, in which the NRSRO derives its revenue from restricting access to its ratings to paid subscribers. After Morningstar acquired Realpoint in the spring of 2010, Morningstar began to expand the scope of its business and initiated an issuer-paid ratings service for initial ratings on commercial mortgage-backed securities. In connection with this expansion, Morningstar has requested a temporary and limited exemption from Rule

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

17g-5(c)(1) on the grounds that the restrictions imposed by Rule 17g-5(c)(1) would pose a substantial constraint on the firm's ability to compete effectively with large rating agencies offering comparable ratings services. Specifically, Morningstar argues that because the fees typically associated with issuer-paid engagements tend to be relatively high when compared to the fees associated with its existing subscriber-based business, in the early stages of its expansion the fees associated with a single issuer-paid engagement have exceeded ten percent of its total net revenue for the fiscal year. Accordingly, Morningstar has requested that the Commission grant it an exemption from Rule 17g-5(c)(1) for any revenues derived from non-subscription based business during calendar years 2012 and 2013, which are the end of Morningstar's 2011 and 2012 fiscal years, respectively.

III. Discussion

The Commission, when adopting Rule 17g-5(c)(1), noted that it intended to monitor how the prohibition operates in practice, particularly with respect to asset-backed securities, and whether exemptions may be appropriate.² The Commission has previously granted three temporary exemptions from Rule 17g-5(c)(1), including one on June 28, 2008 to Realpoint, as Morningstar was formerly known, in connection with its initial registration as an NRSRO ("Realpoint Exemptive Order").³ The Commission noted several factors in granting that exemption, including the fact that the revenue in question was earned prior to the adoption of the rule, the likelihood of smaller firms such as Realpoint being more likely to be affected by the rule, Realpoint's expectation that the percentage of total revenue provided by the relevant client would decrease, and the increased competition in the asset-backed securities class that could result from Realpoint's registration. In granting the Realpoint Exemptive Order, the

² Release No. 34-55857 (June 5, 2007), 72 FR 33564, 33598 (June 18, 2007).

³ Release No. 34-58001 (June 23, 2008), 73 FR 36362 (June 26, 2008).

Commission also noted that an exemption would further the primary purpose of the Credit Rating Agency Reform Act of 2006 (“Rating Agency Act”) as set forth in the Report of the Senate Committee on Banking, Housing, and Urban Affairs accompanying the Rating Agency Act: to “improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry”.⁴

Previously, on February 11, 2008, the Commission, citing the same factors it later set forth in the Realpoint Exemptive Order, issued a similar order granting LACE LLC (“LACE”) a temporary exemption from the requirements of Rule 17g-5(c)(1) in connection with LACE’s registration as an NRSRO (“LACE Exemptive Order”).⁵ Most recently, the Commission issued an order granting Kroll Bond Rating Agency, Inc. (“Kroll”), formerly known as LACE, a temporary, limited and conditional exemption from Rule 17g-5(c)(1) allowing Kroll to enter the market for rating structured finance products (“Kroll Exemptive Order”).⁶ In this order, the Commission noted that an exemption is consistent with the Commission’s goal of improving ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry.

The Commission believes that a temporary, limited and conditional exemption allowing Morningstar to expand in the market for rating structured finance products on an issuer-paid basis is consistent with the Commission’s goal of improving ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry. In order to maintain this exemption, Morningstar will be required to publicly disclose in Exhibit 6 to Form NRSRO, as applicable, that the firm received more than

⁴ See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006).

⁵ Release No. 34-57301 (Feb. 11, 2008), 73 FR 8720 (Feb. 14, 2008).

⁶ Release No. 34-65339 (Sept. 14, 2011), 76 FR 58319 (Sept. 20, 2011).

10% of its net revenue in fiscal years 2011 and 2012 from a client or clients that paid it to rate asset-backed securities. This disclosure is designed to alert users of credit ratings to the existence of this specific conflict and is consistent with exemptive relief the Commission has previously granted to Realpoint, LACE and Kroll. In addition to Morningstar's existing obligations as an NRSRO to maintain policies, procedures, and internal controls, by the terms of this order, Morningstar will also be required to maintain policies, procedures, and internal controls specifically designed to address the conflict created by exceeding the 10% threshold. Furthermore, the exemption would also require that revenue from a single client does not exceed 25% of Morningstar's total net revenue for either fiscal year 2011 or 2012.

Section 15E(p) of the Exchange Act, as added by Section 932(a)(8) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, requires Commission staff to conduct an examination of each NRSRO at least annually. As part of this annual examination regimen for NRSROs, Commission staff will closely review Morningstar's activities with respect to managing this conflict and meeting the conditions set forth below and will consider whether to recommend that the Commission take additional action, including administrative or other action.

The Commission therefore finds that a temporary, limited and conditional exemption allowing Morningstar to expand in the market for rating structured finance products on an issuer-paid basis is consistent with the Commission's goal, as established by the Rating Agency Act, of improving ratings quality by fostering accountability, transparency, and competition in the credit rating industry, and is necessary and appropriate in the public interest and is consistent with the protection of investors, subject to Morningstar's making public disclosure of the conflict created by exceeding the 10% threshold; its maintenance of policies, procedures and internal controls to address that conflict; and that revenue from a single client does not exceed 25% of Morningstar's

total net revenue for either the fiscal year ending December 31, 2011 or the fiscal year ending December 31, 2012.

IV. Conclusion

Accordingly, pursuant to Section 36 of the Exchange Act,

IT IS HEREBY ORDERED that Morningstar Credit Ratings, LLC, formerly known as Realpoint LLC, is exempt from the conflict of interest prohibition in Exchange Act Rule 17g-5(c)(1) until January 1, 2013, with respect to any revenue derived from issuer-paid ratings, provided that: (1) Morningstar Credit Ratings, LLC publicly discloses in Exhibit 6 to Form NRSRO, as applicable, that the firm received more than 10% of its total net revenue in fiscal year 2011 or 2012 from a client or clients; (2) in addition to fulfilling its existing obligations as an NRSRO to maintain policies, procedures, and internal controls, Morningstar Credit Ratings, LLC also maintains policies, procedures, and internal controls specifically designed to address the conflict created by exceeding the 10% threshold; and (3) revenue from a single client does not exceed 25% of Morningstar's total net revenue for either the fiscal year ending December 31, 2011 or the fiscal year ending December 31, 2012.

By the Commission.

Elizabeth M. Murphy
Secretary

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