Credit Rating Agencies

Credit-ratings agencies had been held up historically as neutral arbiters of risk. That turned out to be far from the truth, as evidenced by the numerous mortgage-backed securities and other risky securities that states and municipalities in particular bought because they had been slapped with a AAA rating – meaning they were supposed to be virtually risk-free. The problem was that credit rating agencies made money by giving their customers the ratings they wanted. There was little or no accountability for the agencies because it was nearly impossible to sue them.

Rules & Oversight

- **We Won:**
  - For the first time, the SEC will have an Office of Credit Ratings to keep a watchful eye on the rating agencies' critical role in our financial system. The Office will have the authority to write rules and levy fines.
  - The SEC will have a new mandate to examine rating agency operations.
  - Credit rating agencies will be required to disclose the data and methodologies used in their ratings, as well as ratings performance.
  - The SEC will have the authority to deregister an agency for providing bad ratings over time.
  - Raters must meet standards of training, experience, and competence, and be tested.
  - The SEC shall issue rules to prevent sales and marketing considerations from influencing the production of ratings.
  - Raters will have to take into consideration credible information that comes to their attention from a source other than the organizations being rated.
  - Credit rating agencies are explicitly prohibited from advising an issuer and rating that issuer's securities.
  - The bill eliminates the credit rating agency exemption from the Fair Disclosure rule which provides that when an issuer shares important nonpublic information with certain parties, now including rating agencies, it must make public disclosure of that information.
  - The bill replaces the term "furnish" with "file" in existing statute. Information that is "furnished" to the SEC is subject to a lower standard of accuracy and liability than information that is "filed" with the SEC.

Conflict of Interest

- **We won**: The SEC will create a new mechanism to prevent issuers of asset-backed securities from picking the agency they think will give the highest rating. Unless a stronger mechanism is identified in the SEC study, an independent, investor-led board will assign rating agencies to provide initial ratings of asset-backed securities.

- **We compromised**: The SEC will be given two years to study the conflict of interest caused by securities issuers picking and paying their credit rating agencies before they begin assigning rating agencies.

Liability

- **We won:**
    - Investors will now be able to recover damages in private anti-fraud actions brought against rating agencies for gross negligence in the rating.
    - Registered credit rating agencies will no longer be exempt from expert liability under the securities laws. The SEC originally exempted rating agencies from liability to encourage reliance on credit ratings in the registration of securities. Eliminating the exemption is consistent with the bill's goal of reducing such reliance.
    - The bill clarifies that ratings are not forward-looking statements entitled to special protections from liability.

Universal Ratings

- **We won:** Raters must apply ratings consistently for corporate bonds, municipal bonds, and structured finance products and instruments, based on probability of default.

Reliance on Ratings

- **We compromised:** All federal agencies will review their rules and regulations and eliminate all references to credit ratings. We support a reduction in the over-reliance on ratings, but a sufficient alternate standard of creditworthiness will need to be found for some federal rules.

Rating Agency Governance

- **We Won:**
    - At least half of a credit rating agency's boards of directors must be made up of independent members with no financial stake in credit ratings.
    - When a rating analyst switches jobs, the analyst's ratings will be reviewed and the job change will be made public.
    - Compliance officers isolated from the rating and sales business will be required to file reports on rating agencies' adherence to rules.

Post-Rating Surveillance

- **We lost:** The final bill did not include a requirement that credit rating agencies monitor and update ratings as market conditions change. However, the initial rating assignment mechanism will take into account long-term rating performance.

Public Rating Utility

- **We lost:** Many reformers believed that the best way to solve the problems associated with credit ratings agencies was to create a public agency. This was never really given serious consideration in either the House or Senate.