



FedFin Client Report

Wednesday, August 27, 2014

SEC Clamps Down on Credit Rating Agencies

Client Report: **RATINGS49**

Executive Summary

In concert with its final ABS-disclosure rules (see Client Report **ABS33**), the SEC today also finalized an array of requirements mandated by Dodd-Frank for credit rating agencies registered as nationally recognized statistical rating organizations (NRSROs). Approved by a 3-2 vote, the new standards put NRSROs under a wide array of restrictions designed to improve rating transparency, bar conflicts, and improve accountability. Democrats supported the standards, although Commissioner Aguilar pressed for continued attention to conflicts that he believes inevitably result when issuers pay for ratings. Republicans strongly opposed the new conflict standards on grounds of subjectivity. It remains to be seen how the new approach will change the ratings that, despite regulatory efforts around the world, still drive market pricing, collateral eligibility, and many other critical market factors. It is possible that re-ratings, including downgrades, will be less common due to the new standards applied to them, as well as that overall ratings will be skewed to the most conservative possible one to avoid subsequent regulatory or investor allegations. New CEO-attestation requirements also create greater legal and reputational risk that could make AAAs even harder to get. This report analyzes today's meeting.

Analysis

Key Points

Under the final rules, NRSROs must:

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- establish internal control structures and standards for determining credit ratings;
- periodically review and report to the SEC any material weaknesses in the ratings process, as well as on how these weaknesses were addressed, attested to by the NRSRO's CEO;
- publically disclose information about initial credit ratings and any subsequent changes, as well as the methodology used, any uncertainties, and an assessment on the quality of information available;
- conduct a "look-back" review for any credit analyst that leaves the company and re-rate any security when such a conflict of interest is discovered; and
- establish training standards for credit analysts.

The final rule also sets a broad standard prohibiting sales and marketing staff from working on ratings, preventing any sales and marketing consideration from influencing ratings, and requiring immediate re-rating should any conflicts be discovered.

Statements

Chair White strongly applauded the rulemaking. She was joined by Commissioner Aguilar, who argued that the final rule was a significant improvement from the proposal. He also suggested the SEC consider rules to address conflicts where rating agencies are paid directly by the issuers of the products they rate, as well as issue more detailed procedures to govern look-back reviews. Commissioner Stein pushed for further efforts to ensure that rating symbols are applied consistently.

Both Commissioners Gallagher and Piwowar criticized the rule for its requirements on internal controls and argued that its standards for conflicts of interest are too broad and open-ended. Commissioner Gallagher signaled that he was willing to support the rule had it not been for several last-minute changes in these two areas, while Commissioner Piwowar asserted that the rulemaking goes beyond the mandates in Dodd-Frank.