
WSJ: SEC Is Gearing Up to Focus on Ratings Firms.

Moves by Head of the Agency's Office of Credit Ratings Signal Potential Flurry of Regulatory Activity

The government's top credit-rating watchdog has kept a low profile since taking the job two years ago to help prevent another financial crisis. That may be about to change.

Thomas J. Butler, head of the Securities and Exchange Commission's Office of Credit Ratings, said he has referred multiple cases to the agency's enforcement division and is helping complete several industry regulations to address quality and transparency in how big debt deals are rated.

Those moves signal a potential flurry of regulatory activity involving ratings firms, which have been largely untouched as government oversight has increased in most other financial sectors in recent years.

Mr. Butler, a 56-year-old former Citigroup Inc. C -0.19% executive, has been relatively quiet since launching the office in 2012 to oversee firms including Standard & Poor's Ratings Services and Moody's Investors Service. MCO +1.06% The creation of the office was mandated in the Dodd-Frank financial-overhaul law.

His office has produced annual reports summarizing industry activity and monitored ratings firms to make sure they comply with existing rules that dictate how criteria are developed for evaluating bonds and whether internal protocols are followed, among other things. Mr. Butler's office doesn't have direct enforcement powers over firms, but monitors their activities and can make referrals to the unit headed by Andrew Ceresney, the SEC's top enforcement chief, for potential action. Mr. Butler declined to say how many referrals he has made or what firms are involved.

Some critics have questioned whether the office has moved quickly enough to bring substantive changes to an industry widely blamed for helping trigger the financial crisis, largely by giving top ratings to mortgage bonds that later soured and left investors with billions in losses.

They point out the three biggest firms—S&P, Moody's and Fitch Ratings—still dominate the industry, despite lawmakers saying they hoped to attract new entrants. Momentum to adopt major revisions, such as changing the business model or standardizing ratings across asset classes, also has petered out.

"While we've made some progress, I'm frustrated that key reforms still aren't fully implemented," said Sen. Al Franken (D., Minn.), who wrote a Dodd-Frank amendment in 2010 that would have overhauled the credit-rating business model but hasn't been adopted. Issuers of bond deals pay ratings firms to grade their deals, a model that Sen. Franken and others have said gives firms an incentive to compromise their criteria in order to win business.

In an interview, Mr. Butler acknowledged his office has work left to do, but said, "I couldn't be happier with what we've accomplished." He added that he is seeing "real results" from the firms responding to the findings in the annual reports and recommendations from his staff in routine examinations.

Other SEC officials have similarly indicated the ratings world is increasingly in focus.

Chairman Mary Jo White told Congress in late April that rules improving transparency and rating integrity "are a priority for the commission in 2014." Mr. Ceresney, the enforcement chief, at a Wall Street Journal event last week in Washington said, "You'll see a lot of activity" with credit-rating firms in the near future.

Since the financial crisis, the SEC has taken action against one ratings firm, Egan-Jones Ratings Co. The small firm was barred from rating certain bonds for 18 months, starting in January 2013, for allegedly overstating the number of ratings it had done. "We are glad the matter is behind us," said Alan S. Futerfas, a lawyer for Egan-Jones President Sean Egan.

Mr. Butler is a ratings-world outsider. A Rutgers University law graduate, he spent 14 years at what became Morgan Stanley Smith Barney, Citigroup's former wealth-management joint venture with Morgan Stanley. His roughly 40-person staff represents less than 1% of the SEC's total workforce. Mr. Butler spends most of his time in lower Manhattan, working out of a sparse office with little more than government-issued furniture and a few photos of his dogs.

Mr. Butler said his staff is developing rule recommendations for Chairman White that clarify what disclosures should be made and how best to separate analysts from sales staff. Those recommendations, done with the SEC's Division of Trading and Markets, will be completed versions of regulations that were first proposed in 2011 but not yet implemented.

Rating firms have largely embraced regulation and Mr. Butler's team, saying they give investors added insight into how ratings are determined. Moody's shares the SEC's goals of making the ratings process easier to understand and effective, said a Moody's spokesman.

Adam H. Schuman, chief legal officer for Standard & Poor's Ratings Services, which is owned by McGraw Hill Financial Inc., MHFI +0.59% said Mr. Butler's annual reports have given useful guidance on what the firm should be doing for compliance.

Many smaller firms say some of the regulations and compliance requirements disproportionally affect them, making it harder for new players to emerge. "It's expensive and far easier for the bigger firms to absorb those costs" around email retention, recordkeeping and compliance, said Joseph Petro, chief operating officer at Morningstar Credit Ratings LLC.

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