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WSJ: New Rules Near on Credit-Ratings Firms.

SEC Set to Finalize Measures Aimed at Preventing Conflicts of Interest; Industry Drew Criticism After Crisis

WASHINGTON—Credit-ratings firms may soon face tougher restrictions aimed at preventing a repeat of the financial crisis.

The Securities and Exchange Commission is expected as early as this month to finalize new rules meant to better police the industry, according to people familiar with the process. The effort follows criticism that ratings firms failed to adequately sound alarms about flawed mortgage securities ahead of the housing meltdown.

The rules, expected to be somewhat tougher than those proposed more than three years ago, will take additional steps to ensure that the firms' interest in winning business doesn't affect ratings analysis, said the people familiar with the process.

Credit raters have been lambasted by critics and lawmakers over their actions in the run-up to the 2008 financial crisis. A 2011 U.S. congressional report cited widespread and sudden downgrades of mortgage-related bonds as being perhaps "more than any other single event ... the immediate trigger for the financial crisis." The bonds had previously been given top-notch ratings by the firms.

Ratings firms have acknowledged they didn't fully anticipate the events of the financial crisis but add that regulators and other market participants were also caught off guard.

SEC Chairman Mary Jo White has made completing the rules a top priority as she works through a backlog of unfinished regulations required by the 2010 Dodd-Frank financial law. Consumer advocates criticized the rules proposed in 2011 as weak. The measures languished at the agency until Ms. White arrived last year.

"The proposed rules were so deficient that they wouldn't protect against problems that occurred in the crisis," said Micah Hauptman, counsel at the Consumer Federation of America, which backs tougher rules on the industry. "Chair White has said that the commission's responsibility is much greater than simply checking a box and getting a job done, and this is a test case."

An SEC spokeswoman declined to comment. Credit raters say they are more regulated than in the past and welcome chances to become more transparent.

Corporations and other bond issuers pay ratings firms to provide credit-risk grades for their deals, a setup that critics say gives firms an incentive to relax their criteria to win business. The firms say they are able to manage conflicts of interest. The SEC isn't expected to alter the so-called "issuer pays" model used by ratings firms, but it will impose stronger internal protections to protect against conflicts.

While the rules proposed in 2011 would have restricted sales and marketing officials from participating in ratings decisions, the final rules are expected to also restrict company executives,

the people familiar with the rules said.

The new regulations would also hand regulators more jurisdiction to take disciplinary action when companies break the rules. Under Dodd-Frank, “There are more arrows in the SEC’s quiver,” to penalize bad actors with the proposed rules, said Scott McCleskey, a former head of compliance at Moody’s.

The SEC rules also are expected to require more ratings disclosures for investors and create a clearer process to impose penalties for violations.

“The markets must have clear and consistent rules for credit-rating agencies, and a proper regulatory framework will ensure investors have confidence in the rating process,” said Daniel Noonan, a spokesman for Fitch Ratings, which is owned by Fimalac SA and Hearst Corp.

“Moody’s will implement and abide by the final rules as published by the SEC,” said Michael Adler, a spokesman for Moody’s Investors Service.

Standard & Poor’s Ratings Services spokesman Ed Sweeney said the company had beefed up its compliance department in recent years but declined to comment on the pending SEC rules.

For several years, the SEC’s Office of Credit Ratings, led by Thomas J. Butler, has conducted annual industry exams and monitored the companies. But the SEC inspections, for now, have largely focused on whether raters are following their own company guidelines around ratings methodology or conflict of interest.

Credit raters have already been required to comply with postcrisis regulations in Europe and Canada. In the U.S., companies have created their own safeguards and heavily invested in risk management and compliance staffing.

Companies say they would expect a period of several months to comply with the SEC rules, whenever they are finalized.

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Aug. 14, 2014 6:22 p.m. ET