Administration's Regulatory Reform Agenda Moves Forward:

Credit Rating Agency Reform Legislation Sent to Capitol Hill

Continuing its push to establish new rules of the road and make the financial system more fair across the board, the Administration today delivered proposed legislation to Capitol Hill to increase transparency, tighten oversight, and reduce reliance on credit rating agencies. The legislation would also work to reduce conflicts of interest at credit rating agencies while strengthening the Securities and Exchange Commission's (SEC) authority over and supervision of rating agencies. In recent years, investors were overly reliant on credit rating agencies that often failed to accurately describe the risk of rated products. This lack of transparency prevented investors from understanding the full nature of the risks they were taking. The Administration's legislation would tighten oversight of credit rating agencies, protect investors from inappropriate rating agency practices, and bring increased transparency to the credit rating process.

Conflicts of Interest

Bar Firms From Consulting With Any Company That They Also Rate: Credit ratings agencies will face similar restrictions to other professional service providers, like accountants, and will be prohibited from providing consulting services to companies that contract for ratings.

Strengthen Disclosure And Management Of Conflicts Of Interest: The legislation will prohibit or require the management and disclosure of conflicts arising from the way a rating agency is paid, its business relationships, affiliations or other conflicts.

Disclose Fees Paid By An Issuer Along With Each Rating Report: Each rating report will disclose the fees paid by the issuer for a particular rating, as well as the total amount of fees paid by the issuer to the rating agency in the previous two years.

Look-Back Requirement To Address The Conflicts From A "Revolving Door": If a rating agency employee is hired by an issuer and if the employee had worked on ratings for that issuer in the preceding year, the rating agency will be required to conduct a review of ratings for that issuer to determine if any conflicts of interest influenced the rating and adjust the rating as appropriate.

Designate A Compliance Officer: Each rating agency will be required to designate a compliance officer – reporting directly to the board or the senior officer of the firm – with direct responsibility over compliance with internal controls and processes. The compliance officer will not be allowed to engage in any rating activities, marketing, sales, or setting of compensation; and will be required to submit a report annually to the SEC.

Transparency & Disclosure

Require Disclosure Of Preliminary Ratings To Reduce "Ratings Shopping": Currently, an issuer may attempt to "shop" among rating agencies by soliciting 'preliminary ratings' from multiple agencies and then only paying for and disclosing the highest rating it received for its product. We would shed light on this practice by requiring an issuer to disclose all of the preliminary ratings it had received from different credit rating agencies so that investors will see how much "shopping" happened and whether there were discrepancies with the final rating.

Require Different Symbols To Be Used To Distinguish The Risks Of Structured Products: One of the challenges in the current crisis was that investors did not fully realize that the risks posed by structured products such as asset-backed securities are fundamentally different from those posed by corporate bonds, even with similar credit ratings. Our proposal requires rating agencies to use different symbols for structured finance products as an indication of these disparate risks.

Require Qualitative And Quantitative Disclosure Of The Risks Measured In A Rating: Agencies will be required to provide a much fuller picture of the risks in any rated security through the addition of qualitative and quantitative disclosure of the risks and performance variance inherent in any given security. Ratings cannot be a substitute for investor due diligence. Therefore, to facilitate investor analysis, we will require that each rating also include a clear report containing assessments of data reliability, the probability of default, the estimated severity of loss in the event of default, and the sensitivity of a rating to changes in assumptions. This report will present information in a way that makes it simple to compare this data across different securities and institutions. This additional information will increase market discipline by providing clearer estimates of the risks posed by different investments.

Strengthen SEC Authority and Supervision

Establish A Dedicated Office For Supervision Of Rating Agencies: Our legislative proposal establishes a dedicated office within the SEC to strengthen supervision of rating agencies and to carry out the enhanced regulations required.

Mandatory Registration: Unlike the current voluntary system of registration, our proposal would make registration mandatory for all credit rating agencies. This will bring all ratings firms into a strengthened system of regulation.

SEC Examination Of Internal Controls And Processes: The SEC will require each rating agency to document its policies and procedures for the determination of ratings. The SEC will examine the internal controls, due diligence, and implementation of rating methodologies for all credit rating agencies to ensure compliance with their policies and public disclosures.

Reduce Reliance on Credit Rating Agencies

PWG Review of Regulatory Use of Ratings: Treasury will work with the SEC and the President's Working Group on Financial Markets to determine where references to ratings can be removed from regulations.

SEC Recently Requested Public Comment on Whether to Remove References to Ratings in Money Market Mutual Fund Regulation: As part of a comprehensive set of money market fund reform proposals, the SEC requested public comment on whether to eliminate references to ratings in the regulation governing money market mutual funds, as a way to reduce reliance on ratings. Treasury will work with the SEC to examine opportunities to reduce reliance and increase the resilience of the money market mutual fund industry.

Require GAO Study On Reducing Reliance: In addition to regulatory efforts to reduce reliance on credit ratings, this legislation would require the GAO to study and issue a report on the reliance on ratings in federal and state regulations.

Strongly Support SEC Actions on Credit Rating Agencies

Enable Additional Ratings On Structured Products: Because structured products are often complex and require detailed information to assess, it can be difficult for a rating agency to provide "unsolicited ratings" – ratings on products it was not paid to rate. These ratings, while in existence previously, were ineffective because investors understood that these unsolicited ratings did not benefit from the same information as the fully contracted ratings. The SEC has proposed a rule that would require issuers to provide the same data they provide to one credit rating agency as the basis of a rating to all other credit rating agencies. This will allow other credit rating agencies to provide additional, independent analysis to the market.

Require Disclosure Of Full Ratings History: The SEC has proposed to require NRSROs to disclose, on a delayed basis, ratings history information for 100% of all issuer-paid credit ratings.

Strengthen Regulation And Oversight Of Credit Rating Agencies: In response to the credit market turmoil, in February the SEC adopted several measures to increase the transparency of the rating agencies' methodologies, strengthen disclosure of ratings performance, prohibit certain practices that create conflicts of interest, and enhance recordkeeping and reporting obligations to assist the SEC in performing its regulatory and oversight functions. The SEC has allocated resources to establish a branch of examiners dedicated specifically to conducting examination oversight of rating agencies.

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