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Break-up of ratings agencies suggested

By Eoin Callan and Krishna Guha in Washington and Saskia,Scholtes in New York
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Credit ratings agencies might need to be split up because of serious conflicts of interest in their relationship with Wall Street, the newly-appointed head of a high-level advisory panel to the US Treasury yesterday said.
Eric Mindich, the head of a private-sector group advising the White House, said that investor confidence in the ratings agencies had been "severely damaged" and that their business model had inherent "serious -conflicts".
"I do not think that the market can discipline ratings agencies sufficiently," said Mr Mindich, the chief executive of Eton Park Capital and a former colleague of Hank Paulson, the Treasury secretary, at Goldman Sachs, the investment bank.
The comments mark the first time that a senior adviser close to the administration has proposed the option of ratings agencies being broken up in response to criticism of their role in fuelling the meltdown in the subprime mortgage market.
Lawmakers and investors criticised the companies for giving high ratings to subprime securities and failing to act quickly when borrowers began defaulting on loans backing the bonds.
It may be necessary to separate their rating and consulting arms, or to require detailed disclosure of contacts between them, said Mr Mindich, who was appointed by Mr Paulson on Tuesday.
Rating agencies publish their judgments on credit-worthiness to help assess the risk of investments. Their performance has been criticised in the wake of the credit squeeze that has hit capital markets. Last month the European Commission announced an investigation into their slow reaction to the subprime crisis.
Christopher Cox, chairman of the Securities and Exchange Commission, told the Senate panel his agency was also probing whether companies such as Standard & Poor's and Moody's were "unduly influenced'' by issuers and underwriters that paid for credit ratings.
Jim Bunning, the Republican senator, said "the business model is an inherent conflict of interest" and had fuelled the crisis, while Democratic Senator Charles Schumer said there was scope for a new investor-funded ratings structure.
Vickie Tillman, executive vice president at S&P, defended the "issuer-pays" rating model, in which companies that issue securities pay the ratings agency to assign credit ratings.
The executive said it was the only one that allowed ratings agencies to develop costly ratings procedures without charging investors high subscription fees. Ms Tillman said S&P managed the conflict by making ratings transparent and subject to scrutiny by market participants. She said analysts were not compensated based on the amount of revenue they generated.
Additional reporting by Michael MacKenzie in New York

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Money Trumping Ethics, Sen. Shelby Tells Rating Agency Hearing

"It seems to me that money's trumping ethics," Senator Richard C. Shelby, ranking member on the Senate Banking Committee, said at yesterday's hearing by that committee on "The Role and Impact of Credit Rating Agencies on Subprime Markets." Shelby was referring to possible conflicts of interest by credit rating agencies that are paid to advise companies on how to package and securitize assets (including subprime mortgage-backed securities) to obtain higher ratings, and ultimately issue those ratings. Shelby's comment was reported in Stephen Labaton's article in the New York Times today, "SEC Inquiry Looks for Conflicts in Credit Rating Agencies," (also titled "Debt Rating Agencies Under Scrutiny by SEC" in some editions). Labaton cites testimony of SEC Chairman Christopher Cox at the hearing yesterday, that the SEC is examining potential conflicts of interest at the credit rating agencies for their dual role as adviser and rater.

"In particular," said Cox, as noted in his written testimony, "the Commission is examining whether these NRSROs were unduly influenced by issuers and underwriters of RMBS to diverge from their stated methodologies and procedures for determining credit ratings in order to publish a higher rating. The examination is also focusing on whether the NRSROs followed their stated procedures for managing conflicts of interest inherent in the business of determining credit ratings for RMBS. In this regard, the examination will seek to determine whether the NRSROs' role in the process of bringing RMBS to market impaired their ability to be impartial."

Although some question if the SEC's limited regulatory powers over credit rating agencies go far enough, others say it is worth giving more time for the Credit Rating Agency Reform Act of 2006 and related SEC rules to be applied before exploring further legislation or regulation. This was reported by Rachel McTague of BNA in her article today, "Shelby, Cox Say Allow 2006 Law to Work as SEC Oversees Credit Rating Agencies."

In related news, "Break-Up of Ratings Agencies Suggested," by Eoin Callan, Krishna Guha and Saskia Scholtes in today's Financial Times says: "Eric Mindich, the head of a private-sector group advising the White House, said that investor confidence in the ratings agencies had been "severely damaged" and that their business model had inherent "serious -conflicts".
Mindich, the CEO of Eton Park Capital and formerly of Goldman Sachs, is "the newly-appointed head of a high-level advisory panel to the US Treasury," says the FT. According to the FT, Mindich said yesterday: "I do not think that the market can discipline ratings agencies sufficiently," and the FT states, "The comments mark the first time that a senior adviser close to the administration has proposed the option of ratings agencies being broken up in response to criticism of their role in fuelling the meltdown in the subprime mortgage market.

http://www2.financialexecutives.org/blog/permanent.cfm?post_id=356

Sep 27, 2007, 10:00 AM by Edith Orenstein

Financial News Online

Rating agencies reforms

Mindich suggests splitting US ratings agencies

27 Sep 2007

Credit ratings agencies need to separate their rating and advisory functions because of conflicts of interest in their relationship with Wall Street, the newly appointed head of a high-level US government advisory panel has said.

Eric Mindich, who was named on Tuesday as head of a private sector group advising the White House, said investor confidence in the ratings agencies had been "severely damaged" and that their business model had inherent "serious conflicts".

"I do not think that the market can discipline ratings agencies sufficiently," Mindich said. He said he was concerned that agencies issue ratings and also advise issuers of securities on how to secure better ratings. He suggested it might be necessary to separate those functions or require agencies to provide detailed disclosure of their contact with clients.

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Will credit rating agencies split rating and advisory functions?

Posted Sep 27th 2007 9:45AM by Lita Epstein
Filed under: Bad news, Market matters, Money and Finance Today, Economic data, Federal Reserve

I experienced Deja Vu this morning when I woke up to headlines for a call to split the rating and advisory functions of U.S. credit rating agencies. The problems are not much different than those apparent when the SEC forced the analyst function to be split from the investment banking function after the dot.com bubble burst in the early 2000s and exposed the cozy relationship in most brokerage firms.

Today's subprime mortgage mess helped to expose how the cozy relationship between the rating and advisory functions of credit ratings agencies may have contributed to a lack of warning to investors. Eric Mindich, who was named on Tuesday to head a private sector group advising the White House, believes "investor confidence in the ratings agencies had been 'severely damaged' and that their business model had inherent 'serious conflicts,'" according to a report in today's Financial Times. Mindich is chief executive of Eton Park Capital.

Mindich made this call at the Congressional hearing yesterday where Standard and Poor's and Moody's faced questions from lawmakers. Just like when analysts were criticized for failing to warn investors about the impending stock market crash in the early 2000s, credit rating agencies are being faulted for failing to change credit ratings on bonds when borrowers began defaulting on loans that were backing those bonds.

Credit rating agencies have the primary responsibility to determine the credit-worthiness of bond investments. The European Commission is already investigating why the credit agencies reacted so slowly in warning about the sub-prime mortgage mess.

SEC chairman Christopher Cox also testified at yesterday's hearing that the SEC is investigating whether the credit rating companies were "unduly influenced" by the people paying the bills - issuers and underwriters. The light bulb went off in the minds of both Republican and Democratic Senators. Senator Jim Bunning (R-Kentucky) thinks the "business model is an inherent conflict of interest." Senator Charles Schumer (D-New York) agreed and said there needs to be a new structure.

Vickie Tillman, executive vice-president at S&P, defended the credit rating agencies. She told the Congressional panel that requiring investors to pay for their ratings services would require charging them high subscription fees. If you are investing in bonds and getting worthless ratings for free, wouldn't you prefer to pay something for ratings that truly reflect the risks of the potential investment?

Former U.S. Treasury Secretary Larry Summers agrees there are conflicts of interest inherent in the current credit ratings system. He said: "If you are hired by someone at twice your regular fee to work collaboratively with their people to design a security that will receive a triple A rating from yourself" you are likely to deliver certain results. "There needs to be a lot of cleaning up in this area," according to the report in the Financial Times.

What I can't help but wondering is if all these people knew there was a conflict of interest inherent in the credit rating system, why didn't the SEC do something about it before it became a crisis for investors?

Lita Epstein is the author of more than 20 books including, "250 Questions You Should Ask to Avoid Foreclosure" and the upcoming book, "Complete Idiot's Guide to Improving Your Credit Score."

Treasury Advisory Panel Head Proposes Separating Credit Rating Agencies

Published: September 27, 2007

Washington, D.C. -- The head of a private sector group advising the Bush administration on Wednesday suggested splitting up credit agencies due to conflicts of interest with Wall Street and their part in the subprime mortgage market crisis, the *Financial Times* reports.

Eric Mindich, the chief executive of Eton Park Capital and a former colleague of Treasury secretary Hank Paulson at Goldman Sachs, called rating agencies' business model into question and said consumer confidence in the agencies was low.

Mindich suggested possibly separating agency ratings and consulting arms or calling for thorough disclosure of contacts between them, according to the *Times*.

Ratings agencies have been criticized for awarding high ratings to subprime securities and showing a delayed response when borrowers defaulted on their loans.

In response, Chairman of the Securities and Exchange Commission Christopher Cox's agency is currently investigating if Standard & Poor's, Moody's and other companies were "unduly influenced" by issuers and underwriters who paid for credit ratings.

"The examination will seek to determine whether the [ratings agencies'] role in the process of bringing residential mortgage-backed securities to market impaired their ability to be impartial," Cox said, speaking this week to the Senate banking committee.

SEC reveals clampdown on ratings agencies

By James Quinn Wall Street Correspondent
Last Updated: 1:50am BST 26/09/2007

Seven of the world's leading credit-ratings agencies have fallen under the regulatory auspices of the US Securities and Exchange Commission as part of the clampdown on the sector.
The SEC will now have full oversight of the work of the agencies, which were heavily criticised during the credit crisis for their apparent role in legitimising complex debt instruments by giving them healthy credit ratings.
As a result of the move, all of the agencies will have to disclose how they assign ratings, an issue which has proved to be controversial of late as the credit crisis took hold of institutional investment markets. The seven include the three major players – Standard & Poor's, Moodys, and Fitch – as well as agencies less well known outside the banking fraternity such as A.M. Best and DBRS.
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All the firms are now registered as nationally recognised statistical rating organisations (NRSROs) with the SEC under the 2006 Credit Rating Agency Reform Act. The SEC's new rules mean ratings agencies must disclose their "procedures and methodologies for assigning ratings", as well as making public certain performance measurement statistics such as historical downgrades and default rates.
SEC chairman Chris Cox, who is due to testify before the Senate Banking Committee

today to discuss ratings agencies, said: "The Commission's newly-granted oversight of credit-ratings agencies will protect investors and enhance the reliability of credit ratings by fostering accountability, transparency, and competition in the credit-rating industry."
Although the move was in motion ahead of the credit crisis, it will please those who say the ratings agencies need to be more regulated. At the height of the crisis, the Bank of England fingered ratings agencies, with Governor Mervyn King saying there should be a probe into potential conflicts of interest, as the agencies are employed by banks which create the very products they rate.
The European Commission launched a probe into their work, focused on their governance and their ratings performance. Meanwhile, the US Treasury named two private-sector groups to recommend best practices for the $1.5trillion global hedge fund industry. The groups, which represent investors and asset managers respectively, will draft detailed guidelines for information, valuation and risk-management for the sector. Russell Read of Calpers is leading the investors' group, while Eric Mindich of hedge fund manager Eton Park Capital Management is heading the asset managers' group. The move is a result of Treasury Secretary Henry "Hank" Paulson's review of the US's financial regulatory structure, which he began in June.
A spokesman for S&P said: "We are pleased to have received the NRSRO designation and look forward to providing further insight and transparency to the capital markets."
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US Treasury private-sector advisor suggests splitting credit ratings agencies

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LONDON (Thomson Financial) - A private-sector advisory committee has suggested to the US Treasury that it should consider separating the rating and advisory functions at credit ratings agencies, the FT reported.
In the wake of the credit market turmoil, ratings agencies have been criticised by investors and lawmakers for giving high ratings to subprime securities, and failing to act quickly when borrowers began defaulting on loans backing the bonds, the FT said.
Eric Mindich, chairman of a private-sector advisory group formed Tuesday by the Treasury Department to develop recommendations on hedge fund operations, said investor confidence in ratings agencies has been 'severely damaged', and that their business model had inherent 'serious conflicts'.
'I do not think that the market can discipline ratings agencies sufficiently,' Mindich said in the FT.
Mindich said he was concerned that agencies issue ratings and also advise issuers of securities on how to secure better ratings.
He suggested it might be necessary to separate those functions, or to require agencies to provide more detailed disclosure of their contact with clients, the FT said.
Yesterday, the Securities and Exchange Commission chairman Christopher Cox told

the Senate Banking Committee that the agency is investigating whether companies such as Standard & Poor's and Moody's were 'unduly influenced' by issuers and underwriters that paid for credit ratings.
Ratings agencies are already being probed in the European Union, after the EU Commission last month announced it would investigate their slow reaction to the subprime crisis.
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cml/slm
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