Proposal Would Require Ratings Agencies To Share Liability

By Editor Test *Wed, Oct 7, 2009*

But Moody's CEO claimed that imposing collective liability could spark frivolous lawsuits and create an unpredictable business environment.

Legislation that would hold the major credit rating agencies responsible for each other's strength assessments has been drafted by the chairman of a House Financial Services subcommittee.

Rep. Paul Kanjorski (D-PA)'s bill could help resolve the conflicts of interest that arise when agencies receive fees from the companies whose bonds and financial strengths they rate. He contends that establishing collective liability could spur the powerful rating agencies—Moody's Investors Service, Standard & Poor's and Fitch Rating—"to police one another and release reliable, high-quality ratings."

But Moody's chairman and CEO Raymond McDaniel testified that imposing collective liability could stimulate lawsuits against the agencies and create an unpredictable business environment.

The SEC recently proposed rules designed to address the inherent conflicts of interest in the current system. One SEC proposal would discourage "shopping" for favorable ratings by requiring issuers to disclose whether they had received preliminary ratings from other agencies.

A lot rides on those ratings. The agencies issue ratings on the creditworthiness of public companies, thereby determining their borrowing costs. The ratings also offer an opinion about the creditworthiness of securities, which can determine their prices.

After giving positive ratings to exotic mortgage-backed securities a few years ago, the rating agencies downgraded many of them last year as home-loan delinquencies soared. The securities plummeted in value and became the untradeable "toxic" assets whose illiquidity created a credit crisis and resulted in hundreds of billions of losses for investment banks and their investors.

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