Regulate Ratings Agencies More or Less?

By Editor Test *Tue, May 18, 2010*

Sen. Al Franken (D-MN), the former "Saturday Night Live" comedy writer, wants an independent panel to assign Wall Street deals to rating companies.

Which amendment to the Senate's financial regulation legislation would better address the conflicts of interest that rating companies face when judging the products issued by the firms that pay them:

- An amendment to create an independent government-appointed panel to assign Wall Street deals to rating companies and prevent shopping for ratings. Or,
- An amendment to drop the Nationally Recognized Statistical Rating Organization (NRSRO) designation that puts a misleading stamp of approval on rating agency practices.

Sen. Al Franken (D-MN), the former "Saturday Night Live" comedy writer, proposed the first amendment. Sen. George LeMieux (R-FL) proposed the second.

The Senate approved the Franken amendment, S.A. 3991, by a 64-35 vote, over the opposition of Sen. Christopher Dodd, (D-CT), chairman of the Senate Banking, Housing and Urban Affairs Committee, which drafted the underlying bill, S. 3217, the Restoring Financial Stability Act of 2010.

But Sen. LeMieux' amendment is also part of the packet of changes that have been added to S. 3217, despite its inconsistency with the Franken amendment, according to *Reuters Breakingviews* column in the *New York Times* May 17. The columnists said LeMieux's idea was "a far better outcome" because it prevented a "bureaucratic nightmare" and required "better due diligence by investors."

The Franken amendment would give the SEC the authority to set up a Credit Rating Agency Board, or CRAB, to be made up of investors and independent regulators. The new body would assign a credit rater for a security.

The SEC would determine the size of the board. The majority of members would be investors, with at least one representative of a credit-rating company and one representative of an investment bank. Each year, the board would scrutinize each rating firm's accuracy in grading debt compared with competitors and ensure that all payments were "reasonable."

Chris Atkins, a spokesman for Standard & Poor's, New York, was disappointed. Atkins said the Franken amendment "could result in a number of unintended consequences." It would give rating firms less incentive to compete with one another, pursue innovation and improve their models, criteria and methodologies.

"This could lead to more homogenized rating opinions and, ultimately, deprive investors of valuable, differentiated opinions on credit risk," Atkins said. "Most important, having the rating agency assigned by a third party, whether the government or its designee, could lead investors to believe the resulting ratings were endorsed by the government, thereby encouraging over-reliance on the ratings.”