



Rating Agency Legislation: House Vote Pending, Senate Next?

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- After a painfully slow process that started way back with the post-Enron Sarbanes-Oxley initiatives, a bill finally comes to a vote in the House with the Senate still limbering up to get a bill together.
- Despite more than 4 years of overwhelming evidence presented to the ruling bodies that the NRSRO system has grossly distorted market pricing and turned issuers and investors alike into price-takers with virtually no free market choice, the legislation is still a close call.
- For a very important but arcane topic, somehow the straightforward principles tied to this issue have become more of a partisan topic and been made more into a Washington turf war issue when it should be about "doing the right thing" to allow the free and open—though brutal—competition that makes the US capital markets so innovative.

The word is that HR 2990 (see [CreditSights Testimony on the Credit Rating Agency Duopoly Relief Act of 2005](#) 11-29-05) may come to the House for a full vote today after its most recent makeover by the House Financial Services Committee. The changes to the original bill appeared to be made to minimize (but not eliminate) the turf issue with the SEC but still make it a much more streamlined, transparent, and objective process. The changes were also most likely made to make it more palatable to a more conservative and deliberate Senate Committee that still needs to draft its version and was not inclined to radical change. The SEC is also proceeding with its own follow-through on evolving the traditional NRSRO framework that started back after the Sarbanes-Oxley Act. The legislative process of opening the markets to real competition has generated a slew of Senate and House hearings and reams of highly diverse but overwhelmingly supportive testimony that supported legislative involvement and more rapid change.

Highlights of House Resolution 2990

The Credit Rating Agency Duopoly Relief Act of 2006

- Makes the designation nationally recognized statistical ratings organization (NRSRO) voluntary (you do not have to be one to issue opinions and ratings, but to be an NRSRO for federal purposes you must be one).
- The NRSRO can use qualitative methods, quantitative, or both.
- There will be a process for applications and guidelines for policies, procedures and compliance.
- Sets tight time limits on application turnaround (90 days).
- Ratings policies and procedures must be publicly available.
- Ratings provider has been in the business for 3 consecutive years.
- Restricts certain types of behavior around unsolicited ratings or "notching" (penalizing or refusing to rate instruments with underlying assets not rated by that agency) on assets such as ABS and CDOs.

Based on the version that cleared the House Financial Services Committee

It is a testimony to the speed (and we use the term in the ring-of-the-redwood sense) of the process that since it began we have turned over the entire pool of SEC Commissioners, we are on the third SEC Chairman (Harvey Pitt took it up way back when after mandated by Sarbanes Oxley), we are coming up on our third national election, and the CEO of Enron has been tried, convicted, and is now being buried. Two World Cups have come and gone, but the most telling

sign of how long it has dragged on is that the Red Sox and White Sox have both won a World Series in the interim. Those last two events make even progress on breaking the NRSRO lobbying stranglehold possible. Then again, we would assume Moody's and S&P would like to hold this up for the Cubs.

The incumbents in the NRSRO space seem to be holding up under the strain of the coming regulatory onslaught (also known as open competition). As the one pure-play, it is telling that **Moody's stock has climbed at a rate 17 times that of the S&P 500** (that is even after the recent sharp sell-off) since the first Senate hearings in March 2002. **McGraw-Hill only surpassed 5 times the S&P since they also have all those pesky non-ratings businesses.** With windfall profit margins, eye-popping stock returns, a growing array of acquisitions across the financial media space, the performance of the NRSROs in general also drives home (with all sarcasm intended) that the duopoly (or partner monopoly as some of the harsher Washington testimony declared) will somehow struggle through this perilous period. With margins that top Microsoft and which make ExxonMobil look like a pauper (see [Senate Rating Agency Hearings: Progress Dead Ahead?](#) 3-7-06), it is safe to say that the longer change in this market is stalled, the natural commercial barriers to entry will just be further raised from the almost inherently insurmountable level they are at today.

Meanwhile, the NRSROs just keep on reinvesting protected profits by expanding into other areas of the financial media space that are populated by the same major, well-capitalized firms that are not allowed into Moody's and S&P's space. It is a sweet deal to say the least, but a situation that has to hit the fairness button of even those with a "who said life is fair" philosophy. Moody's, S&P, and even the relatively smaller Fitch just keep on buying assets as they reinvest protected ratings profits into new growth markets and new growth regions where the credit markets are developing. **It is almost incomprehensible that such an unlevel playing field will be allowed to continue in a market that prides itself on innovation, quality, and competition.** For those who have watched the corporate landscape over the years, there has always been a good share of 800-pound gorillas in various industries (oil and gas, software, retail, automotive, aerospace, etc.). The NRSRO duopoly, however, is in a class by itself and makes the 800-pound gorillas in most industries look like undernourished gibbons.

If the HR 2990 bill does get approved this week, it will still be just Round 1 of a scheduled 100-rounder. The Senate bill still has to be tackled in Committee and then get it to the floor. The duopoly will have its lobbyists, law firms, and government affairs SWAT teams trying to turn this into an issue of territoriality and highlight that this is one for the SEC. They clearly want this mired in the less-than-transparent world of the SEC review process since that means slow, slower, slowest. This is more than a little ironic since the duopoly has pushed the angle in the past that the SEC has no right to regulate them. With the threat from Congress, the SEC now has new best friends.

Below we take a crack at some Top 10 Lists on the topic that might be food for thought as the process proceeds from the House to the Senate—that is, unless the forces supporting closed markets and economic inefficiency carry the day.

TOP 10 REASONS TO PASS HR 2990

1. Promote competition- it is a given to most people that work for a living that competition can bring prices down, promote productivity, encourage innovation, and provide more options to the consumer. When profit margins rate among the highest in the industrial universe—if not the economic solar system—then chances are prices will come down as market entrants come in. That is Economics 101. NRSRO 101, however, is that market entrants cannot come in. Quality also can be promoted as part of this. In the case of the NRSRO/Rating Agency business, the only way to effectively break into the lineup will most likely be by providing a higher quality product and a less conflicted "investor pay" model. That means more value-added, higher-information-content ratings products and superior analysis beyond the few little letters attached to an issuer name.

Why more people debating this bill do not weigh that more heavily in the equation means they might have made up their opinion first and have bought into the duopoly company line and the anti-reform, status-quo propaganda. Too many pages of testimony were filed by too many industry practitioners, professors, and economists that it is not worth revisiting at this point. It is both intuitive and empirically evident for those who look. "What is wrong with competition?" as Senator Shelby asked in the last round of Senate hearings on the subject. The House seems to agree and has a head start.

2. Let the markets work- as a philosophical matter, most people tend to believe that sophisticated market players and those who invest capital in companies would be better equipped to sort out what is a good or bad credit product than the folks in Congress and those who hail from non-credit fields on the SEC staff—Commissioners or otherwise. Someone still has to explain why a Beltway lifer or someone on a tour of duty from a law firm knows more than an institutional debt investor or a sales and trading professional at a securities firm about how a rating agency works or how their product are used to manage risk. Congress should make sure competition is not precluded by government policy and the SEC should make sure candidates face some appropriate screening mechanism. That is not much different than what we have with brokerage firms and commercial banks as new players entered the underwriting and bank lending business. The securities houses screamed about the banks, and the banks screamed about the securities houses, but it worked to the advantage of the markets. **In the end, the question is why the entrenched NRSRO duopoly is being allowed to frustrate the market's ability to choose?**

3. Offer choice to consumers- If a sophisticated issuer or institutional investor pays hard-earned dollars for a ratings product, it would appear that his voice should be louder than someone not in the business. It is an economic decision, and economic decisions are the best indications around where one finds (or does not find) value and quality. Congress and the SEC should make sure the ability to make choices is protected and that economics and the value decision can actually rule decision-making. It should not be about backroom "lawyering" and lobbying and certainly not about a lack of options.

4. Encourage innovation and upgrade the "information value" of ratings services- charging investors for the quality of product promotes quality and innovation. After all, without a quality offering, there is no revenue. No revenue, then no investment, no staffing, and no market impact. Then there is no business and no capital can be raised. On the other hand, forcing investors as well as issuers to be price-takers to buy a product that *must* be read by virtue of an issuer-based duopoly structure is just economic waste (but juicy profits for a duopoly). The agencies are thus now also working on a captive investor-pay subscription product that must be read by virtue of the duopoly's market share lock on the issuer-pays business. Ratings companies should compete on the quality of the analysis and price, and by forcing that type of competition, information content beyond the "BB" or "B" will be swing factors. It is why we believe ratings companies with both qualitative and quantitative products will carry the day. They will appeal to the broadest range of investors.

5. Exploit a unique opportunity in the market as credit research resources are redeployed- with so many changes in terms of how credit research is delivered by the street and the bulge bracket both in the US and Western Europe, the timing has never been better to redeploy more of that talent pool to the unbundled research space—whether for ratings services, risk management, or securities research. There has also been a booming interest in financial analysis and the securities markets across Asia with India becoming a hub for financial data products that go right at some of the core NRSRO products. In other words, the manpower is there, business models are being developed, and the capital is ready to roll.

6. Speed up the SEC and make it more accountable on the NRSRO issue- the SEC has moved very deliberately on the issue, but unfortunately the cast keeps on changing. Our own experience testifying on this issue at the SEC (see [SEC Hearings on the Ratings Agencies 11-20-02](#)) underscored that the diligence was there on the part of the SEC and the interest in improving the system was very strong. After a lot of hearings, study and fact finding and a few mega-pdf documents, however, the SEC decided it did not have the authority and needed Congressional support. That took a lot of time off the game clock, more SEC commissioners come and go, more time elapses, and more of the post-Enron sense of political urgency fades. All the while, the duopoly grows, makes more acquisitions across segments of the financial media space, and invests heavily in new markets regionally and by markets (bank loans, emerging markets, securitization, etc.). To top that delaying game off, capital entering the NRSRO space is further delayed and the natural barriers keep on rising. The new legislation keeps the SEC very much in the game to be hard working and competent, but it recognizes the trail of failures to get this ball rolling and essentially forces permanent structural change. The SEC has a thousand other major projects to work on and not enough budget or staff. Seems this simplifies life despite the bruised sensibilities around turf.

7. Open up the NRSRO markets to more large strategic players- the rating agencies are hardly staying up late at night worried about a few boutiques—including some that probably have less in revenues than the duopoly spends on lobbying and legal fees and who have less staff than the Moody's and S&P legal and governmental affairs headcount. The real game comes with an influx of any of the larger strategic players from the financial media or financial tech space (Bloomberg, Reuters, Thomson, Morningstar, Bertelsmann, Informa, etc.) or more well-capitalized private equity players with strong financial technology experience. The latter could be looking to roll up firms globally with service capabilities across markets and regions. Last but not least, the competitive push could come from non-US companies looking to start a global ratings firm that cuts across more of the mature markets but also still exploits the great opportunities in developing local-currency credit markets or in developed markets where disintermediation of the banks is much less further along (e.g. Japan, Western Europe). The duopoly wants to keep their big lead going and use their massive profit margins in the US to reinvest offshore. This expansion could be in any combination of the still-growing pan-European credit markets (Western and Eastern Europe) and the developed and developing regions of Asia. There is also the desire to exploit the changes in global banking system regulations that allow for greater use of external ratings agencies for risk management. These are great business lines for many large, well-capitalized players including those with a tech bias in their product mix. **These strategic players are coming. Moody's knows it. S&P knows it. Fitch knows it. They just do not want too many coming in too soon or Congress speeding the process up.**

8. Open up the NRSRO business to more capital- establishing meaningful scale in terms of sector coverage, hiring analysts, expanding the geographic scope of coverage, demonstrating breadth along the credit spectrum and across asset classes, building content delivery platforms, setting up an administrative and compliance capability all requires a fair amount of capital to go with a fair amount of revenue. If the barriers come down and the opportunities are real, there is ample private equity capital looking at the space. We could even see strategic players dipping into their coffers for an equity stake (e.g. the recent major Hearst investment in Fitch) to plant a flag in the space as it evolves.

9. Create opportunities for cross-border consolidation- in addition to the US being the hub of the ratings industry, it is also a market where growing non-US firms could look to grow via acquisition of up-and-coming research firms where research and distribution channels could be leveraged to cross-sell offshore capabilities to US-based global investors. The US has the most developed private pension and mutual fund system with a large base of investments in nondollar securities and non-US issuers. Firms with capabilities in various regions (China, India, Russia) could expand here via acquisition of (or by being acquired by) smaller NRSROs just as Moody's and S&P have been expanding outside the US. With the NRSRO barrier as it exists today, that creates one of many one-way streets for Moody's and S&P that allows the duopoly to expand in

other markets while others cannot expand in Moody's and S&P's home market. Take those barriers down and the more rapid growth of more viable *global* rating agencies with varied strengths across regions will be much more likely sooner rather than later.

10. Create more entrepreneurial drive in a traditionally bureaucratic space- the markets are more complex than ever and there is definitely a blurring of distinctions across ratings services, quantitative risk products, assessing the risk of various asset classes, various regional markets, or the full array of risk management disciplines (regulatory, supplier chain, etc.). That creates opportunities for competitors that can provide any combination of experienced personnel, proprietary data, technology, distribution capabilities, or simply capital and relationships. You never quite see it all until the artificial barriers comes down. Entrepreneurial spirit could do a lot for this space.

THE TOP 10 REASONS THE AGENCIES WANT TO DERAIL LEGISLATION

1. Protect partner monopoly pricing power- Enough said. The ratings agencies have the highest margins this side of the Colombian agribusiness sector. The market is a price-taker, and it is a beautiful thing to see as a shareholder. That issuer-pay model works as an annuity for frequent issuers and as a cost of "passing go" for any new issuer. The agencies have such dominant market share that they are now trying to pass on the "price-taker" business model to the investor subscription business since you need to know what they are thinking. Even if you do not think their research is value added or not high quality, you need to be a student of their rationale since they can impact securities pricing and credit spreads. That is rooted in the unnatural barriers that are set up and we have come full circle.

2. Preserve dysfunctional demand characteristics- whether you want it or not, the issuer basically is required to pay for the ratings in the US market to gain market access. It costs the issuer more "all-in" in funding costs if he simply refuses to pay, so he pays. In the bad old days, failure to pay also meant a hostile, unsolicited rating anyway, but those behavioral issues are also being addressed in some form in this bill for the issuer-pays ratings players. So in the end the issuer pays and takes a crack at improving his chances for a better rating, and maybe the issuer enlists his banker with their rating agency advisory groups (staffed by ex-rating agency personnel) to help. As we indicated, the investor demand pattern also is skewed. In many cases, the investor has to buy the subscription services of the agencies as well whether he likes it or not. After all, knowing what the duopoly thinks (or does not think in some cases) can wag the markets and influence portfolio performance, capital adequacy, securities liquidity, etc.

3. Maintain the ability to reinvest protected ratings profits into new business ventures- stock price performance is in the end largely about margins and growth rates and leveraging strengths to develop more revenue streams off a semi-fixed cost base. The agencies are masters of this but they have the support of a protected ratings services goldmine with essentially guaranteed demand, rising volumes in a growing global market, and virtually guaranteed price increases. They get to take that and reinvest in other globally scalable data businesses, leverage the exiting client base for new consulting and risk management services, and they get all the while to sell these services to the people they rate.

4. Maintain exclusivity of ties to "the street"- in the underwriting process, the street is about relationships and doing the best they can to manage those relationships, tighten the ties, and control the flow of information to the extent possible. The rating agencies fit very much into that model just as a major issuer or banking client does with an investment banker. The street spends many millions annually on professionals to work in rating agency advisory capacity. Yes, the agencies are that powerful. It will take a major well-capitalized force to crack into that relationship chain, and that will only come over time if the Bloombergs or Reuters of the world (among numerous others) step into the fray. It takes a lot of capital, global reach, and brand power to crack the "issuer pays" model. If this legislation and the SEC follow-through takes the direction that a only a few boutiques get dribbled in slowly but surely, the passage of legislation will be a hollow victory for competition and the duopoly will be privately doing an end zone celebration while crying "unnecessary, unwarranted" legislation.

5. Maximize ability to leverage ratings into "consulting" and "other services"- right now the rating agencies cannot acquire platforms, data, and technology fast enough to fuel their expansion. The plan is basically to enter new businesses and drive as many ancillary revenues off that base of clients as they can across departments, asset classes, across regions, and up and down the elevator banks. The most toxic topic that everyone has stayed away from is the fact that an agency rates a company and can have a major influence on the economics of its business (cost of funds, claims paying ability, mutual fund ratings, etc.) but also can walk into their office to sell them other goods and services. We have been down that road with the accounting firms and the audit-consulting conflicts. The most interesting service is "pay us a fee to evaluate a transaction and we will tell you how you look if you do it." The conflicts there go above and beyond to a new level.

6. Keep issuers from opting out of the issuer-pays model- one major threat (and even then only over longer time frames) is that **more choice among viable competitors can give the issuer the opportunity to simply not pay Moody's and S&P**. Then the traditional duopoly has a choice: compete on an investor-pays basis only for that issuer or leave the "issuer-pays playing field" open to other players that might win the issuer over at lower fees (maybe not everybody expects 50+% profit margins). If the agency reaches the bulk of the relevant investors (for example, an issuer might be only placed with large US institutional investors, UK sterling investors etc.) then the new NRSRO they work with might serve just fine—especially if they have a respected product and broadly disseminated ratings. This means competition based on price, quality, and depth of coverage on that issuer. One would expect the big agencies have to be worried about this economic risk, which is why they are making so many acquisitions in the high margin data and analytics businesses and pushing for global scale. In the end, quality and price benefits from such trends.

7. Avoid scrutiny around the agencies' move into investment advisor activities- the agencies have been taking large leaps in recent years to be more "market relevant." In our view, they had been standing right on the line of making investment recommendations and now have crossed the line with market-based ratings products, active use of spread data, and setting projected recovery rates. We certainly have no issue there at all with them moving into that space. It is called competition. Those activities are also typically regulated, however, and the agencies still insist that are just a bunch of happy-go-lucky journalists exercising their First Amendment rights. As one law professor more or less stated in his testimony deriding their First Amendment arguments: "Why not just disband all NASD oversight of research analysts and what they write then?" In effect, self-regulation of behavior could be good for everybody and not just Moody's and S&P. It comes down to whether the nature of the activities the agencies are engaged in are a critical part of the underwriting process and border on recommendations and price targets (e.g. recovery rates) or not. In many cases, that is exactly how their products have developed.

8. Slow the growth of offshore options for non-US issuers- there has always been a strong interest among the European authorities in a less US-dominated rating agency industry (Fitch may be owned by a French industrial but it still is very much rooted in the US markets and the roll-up of several US-based firms apart from IBCA). Similarly, markets such as Japan, China, and India will see more independent ratings services as the local corporate bond markets develop. To be a major force in global ratings and cross-border issuance, the deepest and most lucrative market is still in the U.S., however, and to the extent non-US players can be kept in NRSRO limbo, that will undermine the ability of an aspiring non-NRSRO to be as effective in expanding a global platform that requires a major stake in the US. In effect, obstructionism on the home front can pay dividends for the duopoly outside the US as they keep looking to expand in non-US domiciles.

9. Limit risk of new legislative initiatives in the future around liability exemption- as has been covered in a number of the hearings, the NSROs are exempt from expert liability under Section 11 of the Securities Act of 1933. In the words of the Investment Company Institute, which has always challenged this exemption, "The exemption of NRSROs from the normal liability provisions of Section 11 means that they are not held to a negligence standard of care. As a result, we believe the exemption lessens the incentives of NRSROs to issue reliable securities ratings." The duopoly has to worry that this current legislation could be the start of some gradualism that leads to more legislative changes to level the playing field across the research disciplines (as in make them liable). We seriously doubt that is the case given how hard this fairly straightforward legislation was to even get to this stage.

10. Limit competition for ratings agency personnel- the agencies would face more competition for personnel if more serious players entered the NRSRO space, and there would be more career options for their people. They also will probably all get raises the next day (if I am at Moody's and/or S&P in the rank and file, I root for this bill). Higher costs and lower pricing over time on services translates into lower margins. As they say, try to make it up on volume. Moody's and S&P have probably thought through the math on this one and the risks worry them. There is a large pool of personnel available in credit-related functions that may be in secular decline (bank lending and sells-side research) or in regions where the credit markets are newer and trained analysts are coming on line quickly. The disintermediation of the banks in more mature markets such as Europe or the growth of developing capital markets such as India and China will bring a wave of talent. Senior ratings personnel with significant experience will have more than 3 boxes to check (Moody's, S&P, or Fitch) if this bill goes through. Guess who wants to stall that possibility as long as possible? It could be reminiscent of the expansion of the global bulge bracket where personnel in more concentrated markets such as Mortgage Backed Securities ventured out to new employers for more responsibility, the compensation, or just because they did not like somebody. It is called the free markets—something the NRSROs are not used to (other than the freedom to raise prices regularly).

THE TOP 10 PLOYS TO KILL LEGISLATION

1. Change the topic from competition to self-regulation- the leading agencies seem to be masters of the Jedi Mind Trick. The topic at hand on the most part now is about legislating a more rapid lowering of barriers, and their response is to say the industry needs to follow the lead of the European Commission around self-regulation (which in turn was based on the findings of the International Organization of Securities Commissions). Talk about competition and they come back talking about self-regulation. HR 2990 does in fact detail some understandably prohibited behavior of the more egregious sort, but mostly the bill is about speeding up market entry and promoting competition—not regulation. In the end, the duopoly's actions indicate that they are dead set against both competition and regulation—especially the latter. In terms of regulation, their view remains that nobody has the right to regulate them (despite a clear drift toward asset valuation work as they set recovery rate targets and in market-based research where they use words like "rich" and "cheap"). Their views on regulation is the equivalent of thumbing their nose at the very SEC they have temporarily allied with to slow the legislative momentum down by playing to turf sensitivities.

2. Promote the need for more study on the topic, as in delay, delay, delay- the more that time goes by, the more profits the duopoly can bank, the more acquisitions they can make, the more new products they can proliferate, and the more they can raise the barriers as global markets grow. The stalling ploy has worked well and the government has more than obliged. The clock is ticking, and hopefully the Senate will set a short timer on its version of the legislation.

3. Waive the First Amendment flag- despite more than a few well-pedigreed law professors standing up and deriding this legal angle as laughable, the agencies have worked this one in the back rooms with the power brokers quite successfully. As a result, the issue of regulation was by and large ducked with a *voluntary* feature of the NRSRO proposal in HR 2990. The fact that almost none of the lead financial publications have picked up on coverage of this legislation up to now or delved into the nuances of the debate in other than minimalist fashion tells you the First Amendment mafia is alive and well (the hearings were barely mentioned in any of the lead dailies in recent years). With the all-too-cozy overlapping of First Amendment legal advisers across some of these publications, it is a tad suspicious in terms of what the overriding philosophy was that made them scarcely cover this legislative process in much detail. They will have a hard time ducking coverage of the vote today, however. The sweet content deals with some of the NRSROs across some of these organizations also raises eyebrows and colors the influences that may have led to this debate being largely tabled or addressed in only cursory detail. That goes for the "right" and the "left" of New York dailies. The what-goes-around-comes-around code of silence about media competitors seems to be working well here.

4. Spread stories of the "quality" bogeyman- the fear of low quality competition seems to answer its own question. If it is low quality, it is not competition. After all, if a wannabe NRSRO is low quality they will have no revenue, no staff, and raise no capital. They will be the tree in the woods and nobody will be there to listen. For the duopoly and those looking to derail the bill, hyping the quality fear is always worth a try. Overall, the ratings inflation "race to the bottom" pitch sounds reasonable but not when held up to the reality of market visibility and what investors will actually use. The fact that it totally ignores the investor-pays model also is beside the point even if that is another reason why this overplayed fear is pretty legless. Under this scenario, issuers will line up to pay any new NRSRO for higher ratings. Under this scenario, the market then will blindly fall into line in a Shaun-of-the-Dead gait and lumber off a risk management cliff. The fact that the issuers will still need to pay S&P and Moody's for a rating for years to come is ignored (or that Moody's and S&P can still do unsolicited ratings subject to some behavioral checks). The reality remains that Moody's and S&P have an almost overwhelmingly dominant market share and are often *specifically named* in loan agreements, prospectuses, counterparty agreements, and in portfolio investment parameters. That makes this perceived "race to the bottom" issue (a derivative of the quality issue) pretty nonsensical since Moody's and S&P still rule—and for a long

time. It also ignores the fact that the debt markets remain dominated by sophisticated institutional investors who know the difference.

5. Hype disruption in the market- the main market that will "disrupted" will be the market for guaranteed price increases for Moody's and S&P services. As more high quality players enter the market, the Big Two will need to compete with more players across more markets and product segments. An NRSRO system will still exist under this bill when the smoke clears. If the whole NRSRO system was scrapped (at the 2002 hearings, some commissioners explored that idea), the administrative burden would have been higher to change investment guidelines, amend prospectuses, etc, but the disruption would still be in a practical sense minimal. They would just name the approved agencies specifically.

6. Discourage investments by major strategic players- the NRSROs are actively pushing for the upgraded, new-and-improved version of the SEC's old NRSRO process to keep things murky and slow and to make sure that there is a higher risk factor attached to the uncertainty of the approval process. The legislation as proposed streamlines the application process and in some ways puts a burden of proof on the SEC to make their case in a short time frame. This legislation would reduce the risks for large, well-positioned firms. Whether they would want to deal with a 3-year waiting period is a separate question. Since this bill does not prevent entering the space as a non-NRSRO credit firm, the larger players can get started and be ready in 3 years. They might feel better about that waiting period if they felt the process at the end of that time frame was "cleaner."

7. Discourage new capital flowing into the space- the duopoly and some of their allies know that competition only grows with capital, and they seem to be attempting to slip in provisions that can create problems for private equity players and more disclosure-sensitive international investors (especially private companies or private equity). One tactic is to require financial statements be made broadly public as opposed to the statements only being made available to the SEC on a confidential basis. That is a trick to discourage private equity players or non-US companies that might not make financials public. Financial viability is hardly going to be the main swing factor for anyone entering the NRSRO space. The swing factor will be access to capital, and the duopoly will do whatever they can to limit that capital availability.

8. Promote the SEC effort to stay with a modified status quo approach- in almost-unseemly fashion, the duopoly has thrown its arms around the SEC even though it has never recognized the right of the SEC to regulate the industry and fought tooth and nail any attempt by them to do so. The beauty of the SEC approach for the duopoly is that the information flow is easier to influence, the channels are narrow and tough to navigate (especially with so many rating agency lobbyists, lawyers, and government affairs types in the room), and the process becomes inherently more subjective. **A cleaner, objective process with time constraints and transparency and legislative force behind it will make the effort to obstruct less rewarding for all.** If legislation fails, the duopoly will also most likely will try to start a fresh round of protracted multi-year debates on criteria and have more hearings and public comments of the sort that just ate up the last 4 years. Then we can have some more new commissioners come on less familiar with the topic and keep the "four-corner offense" going to protect the lead.

9. Reinvent the Enron story line- virtually all the hearings use the word "Enron" and the recent Senate hearing in March was no different. The rating agency mantra is "they lied to us." Fair enough. Then again, the rating agencies have never taken any responsibility for their failure to use their massive leverage or Reg FD exemption *after* that fateful 3Q'01 earnings call as the run-on-the-bank escalated and the commercial banks layered in structural seniority (and some banks even rushed to close out swaps). The agencies all the while failed to use their Reg FD exemptions responsibly and use the absolute leverage over Enron that was inherent in the ratings triggers. If they had made demands and pulled the trigger day one, bondholders would have lost less.

10. Exploit partisanship, if available- it is difficult to see how an issue as straightforward as this current one—promote competition on the one hand or promote high artificial barriers, distorted market dynamics, and inefficiency on the other—could possibly get partisan, but there were some hints of that in the House committee process. The bill was sponsored by a Pennsylvania Republican (Rep. Fitzpatrick) and a competing bill (that read like the straight duopoly company line) was pushed in committee by another Pennsylvania Congressman who also just happens to be a Democrat (Rep Kanjorski). He is also the most senior Democrat on the Capital Markets Subcommittee. That competing bill—sort of an enhanced status quo—seems to offer little meaningful change. The Big Two of the agencies naturally are throwing in with that version, and the duopoly can take solace in the fact that a partisan turn could make the Senate bill hard to push through later. As an outsider, you look at the path the legislation has taken and it looks like the GOP had taken the initiative on "heads," so the Democrats just went with "tails."

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