Department of Justice

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DOJ URGES SEC TO INCREASE COMPETITION FOR SECURITIES RATINGS AGENCIES

Washington, D.C. -- The Department of Justice today urged the Securities and Exchange Commission to modify its proposed rules for securities ratings agencies so that new rating agencies could more easily enter the market, thereby increasing competition. The Department did express overall support for the SEC proposals.

In addition, the Department recommended that the SEC require ratings agencies to disclose when they rate a security offering that was not requested by the issuer of the security.

These two recommendations were among comments filed with the SEC by DOJ's Antitrust Division. Today's comments supported proposals for regulating the agencies that rate the creditworthiness of securities offerings. These proposals would help ensure that securities ratings were credible and accurate.

Securities ratings are issued by Nationally Recognized Statistical Ratings Organizations (NRSRO's). Under current policy, NRSRO's are effectively the only firms that can issue securities ratings for many uses in the United States. The proposed rules would formalize the criteria for NRSRO status.

One provision in the proposed rules would require a ratings agency to be recognized as an issuer of credible and reliable ratings by the predominant users of ratings in the United States before being recognized as a NRSRO. This provision could protect incumbent firms from additional competition and would prevent well-capitalized firms with reputations for quality financial analysis from entering the market.

"The SEC's proposal would erect a nearly insurmountable barrier to entry by new and well-qualified firms into the market for securities ratings services. This could have chilling effects on competition and could raise prices for securities ratings," said Joel I. Klein, Assistant Attorney General for Antitrust.

To ensure that a ratings agency entering the market can perform adequately, the Department proposed that the SEC grant provisional status for a new entrant for the first 12 to 18 months of its existence.

In its other recommendation, the Antitrust Division urged the SEC to require ratings agencies to disclose when they assign ratings not solicited by the securities issuer. Such "unsolicited" ratings may not be as accurate as ratings by retained agencies. When agencies make an unsolicited rating, they usually do not have access to the same type and amount of information as in a solicited rating.

"When unsolicited ratings are not based on the same type of information as solicited ones, the ratings agency runs the risk that its rating is not accurate. When the fact that a rating is unsolicited is withheld from investors and the capital markets, they cannot assess the credibility of the rating," Klein said. "Disclosure benefits the markets and improves competition, which benefits consumers."

One of the proposed SEC criteria requires rating agencies to use systematic rating procedures to ensure credible and accurate ratings. Another requires the ratings agencies to have access to senior management because such access enables them to better evaluate the securities. Agencies giving unsolicited ratings may not have had access to senior management. Requiring agencies to disclose that a rating was not solicited will help ensure that the SEC's criteria are met.

The SEC's proposed rules appeared in the Federal Register on December 30, 1997. The public comment period closed this week, and the SEC will determine what, if any, proposals will become rules. There is no set timeline for an SEC decision.

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