

## Big Three ratings agencies remain 'critics for hire'

Little cracks have begun to show in the Big Three rating agencies' hold on their market, but it's still difficult to envision a collapse of the wall that's holding back the floodwaters of debt-rating reform.

The NY Times sure isn't betting on it, gauging by the tone of its big story this morning on how the more things change the more they stay the same. The article explains how everybody's complained that Moody's, Standard & Poor's and Fitch still get 85 percent of all credit-rating business in spite of the fact that the Big Three so vastly overstated the quality of so many of the assets whose subsequent sudden emperor-has-no-clothes markdown led to last fall's market crisis (and the Great Recession). The article notes that there is practically no movement in Washington to outlaw the "critic-for-hire" business model that lets the agencies be paid by the very entities whose debt is being rated. And Congress isn't pushing to remove the agencies' special government-conferred status that makes their imprimatur so important to the municipal bond market. Yes, there is legislation in progress, but its impact will be minimal. The quote o' the day is from Joseph A. Grundfest, a securities-law professor at Stanford: "What you see in these bills are Botox shots," Grundfest says. "For a little while, everyone is going to be frozen into a grin, and then the shots are going to wear off."

However ... where Congress is too skittish to take action, others are stepping forward, offering some hope to an investing public that is mystified at the absence of legislative reform. The big ratings agencies today, sitting fat though they may be, still have to contend with 1) an almost daily legion of bad press 2) a raft of lawsuits by outraged investors and 3) the rise of competition. It may not be the right witches' brew to put the agencies-as-we-know-them out of business, but it's a combination that has potential. Perhaps the most potent ingredient, built in part on Nos. 1 and 2, is No. 3.

Note that last week Morningstar began issuing ratings on corporate debt, starting off with ratings on a modest number (100 companies) but promising to expand its list to 1,000. This would provide actual competition to the Big Three. There's also the upstart Realpoint, which wants to become a rival to the big boys, and last week was picked by J.P. Morgan Securities to rate a big deal. Last year, one should also note, Realpoint received the much-coveted Nationally Recognized Statistical Ratings Organization from the SEC and this year became a TALF-approved rating agency and in September was designated an "acceptable ratings organization" by the National Association of Insurance Commissioners. That last organization, by the way, this fall hired PIMCO, which runs the world's biggest bond fund, to help it rate complicated mortgage-backed assets, a job the Big Three used to be entrusted with.

At some point, a movement gains critical mass, and although this one isn't there yet, it's possible that a certain significant momentum has been achieved. The Big Three have reached out in response to assure investors (and clients) that they do good work, but they also continue to bite the hand of the very investment community that feeds them. One small example, which I wrote about last week on SecuritiesOperations.com, involves a dispute between S&P and an influential group called the European Fund and Asset Management Association over S&P's practice of charging for ISIN numbers - a small but important bit of data that oils international trade and that the association's many members think should be free because it costs so little to generate and distribute.

S&P said the association should buzz off, which might not have been the best move because hedge funds, family offices, fund managers and so on -- that's where the money is, isn't it?

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