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Fitch Comments on U.S. Financial Reform Act's Implication for Credit Rating Agencies

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Fitch Ratings-New York/London/Singapore-19 July 2010: Following months of consideration, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was passed by the U.S. Congress last week and is expected to be signed into law by President Obama this week.

In addition to the far-reaching areas of the financial markets covered by the act, the Dodd-Frank Act provides enhanced regulation, transparency and accountability for credit rating agencies, objectives that Fitch Ratings supports and believes are constructive for all credit rating agencies and the capital markets as a whole. Fitch is committed to implementing the provisions of the Dodd-Frank Act specific to credit rating agencies in a timely and effective manner.

The unprecedented events of the last two years have changed expectations for credit rating agencies and Fitch has made a number of changes to its rating process to address these expectations. Since the beginning of the financial crisis, ongoing improvement of the rating process has been a special focus as Fitch has adapted to rapidly changing market realities.

As Fitch addresses the enhanced regulation of the Dodd-Frank Act, as well as the increased expectations created by worldwide regulatory reform, Fitch will keep the market informed of its changes as they are implemented. Fitch expects to make a range of changes that will provide greater transparency, more rigorous processes and heightened verification of the information Fitch is provided by issuers and underwriters. The new procedures will differ among different rating categories, but enhanced requirements will be adopted throughout Fitch. While the differences will be most noticeable across ratings of mortgage-backed securities (MBS), asset-backed securities (ABS) and other structured products, the ratings processes for corporate credits, financial institutions, municipalities and even sovereigns will also be strengthened.

There are certain provisions of the Dodd-Frank Act applicable to credit rating agencies that are effective immediately and deserve special attention from all market participants.

The Dodd-Frank Act repeals Rule 436(g) under the Securities Act of 1933 (the Securities Act), which relates to U.S. public offerings registered under the Securities Act. Before repeal, Rule 436(g) provided that credit ratings assigned by a Nationally Registered Statistical Rating Organization (NRSRO) are not considered a part of registration statement prepared or certified by an 'expert', as described within the meaning of sections 7 and 11 of the Securities Act, and the NRSRO consent would not be required to include credit ratings in Securities Act registration statements and any related prospectuses.

Historically, credit rating agencies have never been treated as experts under the Securities Act, appropriately so since ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. While Fitch continues to believe that it is not an expert under the plain meaning of sections 7 and 11 of the Securities Act, it is Fitch's understanding that, absent clarification by the U.S. Securities and Exchange Commission (SEC), immediately after the Dodd-Frank Bill is signed into law an issuer will need to obtain Fitch's written consent to include a Fitch credit rating in a Securities Act registration statement and any related prospectuses. If Fitch provides its consent for ratings to be included into Securities Act registration statements or prospectuses, Fitch will be potentially exposed to 'expert' liability under section 11 of the Securities Act, liability to which Fitch is not currently exposed. Fitch is not willing to take on such liability without a complete understanding of the ramifications of that liability to Fitch's business and the means by which Fitch may be able to effectively mitigate the risks associated therewith. While Fitch will continue to publish credit ratings and research, given the potential consequences, Fitch cannot consent to including Fitch credit ratings in prospectuses and registration statements at this time.

In addition, the Dodd-Frank Act directs the SEC to remove the exemption for credit rating agencies from the SEC's Fair Disclosure Rule (Regulation FD) within 90 days of the enactment of the Dodd-Frank Act. The exemption for credit rating agencies from Regulation FD permits issuers to provide the credit rating agencies with material non-public information without requiring public disclosure of such information. To the greatest extent possible, Fitch will work with the issuer community to put in place appropriate mechanisms so that Fitch can continue to receive confidential information as part of the rating process.

Issuers should consult their legal counsel with respect to the effect of these issues on the issuer and any planned securities offerings.

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