Moody's, S&P, Fitch Face Securities Ratings Hearings (Update2)
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(Adds delay of House hearing in second and 14th paragraphs.)

By Dakin Campbell

Sept. 24 (Bloomberg) -- Moody's Investors Service, Standard & Poor's and Fitch Ratings face scrutiny today by insurance regulators examining the role of the firms in evaluating fixed-income securities.

State insurance regulators are meeting in Maryland to examine the firms' role in rating bonds held by insurance companies. A second hearing scheduled today, by Edolphus Towns, chairman of the House Oversight and Government Reform Committee, was postponed to Sept. 30. The panel will look at ratings companies amid allegations of continued conflicts of interest from a former Moody's analyst.

The three companies have been criticized by investors and lawmakers including Senate Banking Committee Chairman Christopher Dodd, who said they wrongly assigned top credit rankings to U.S. subprime-mortgage bonds just before that market collapsed in 2007. Subprime mortgages helped spark a housing-price collapse that contributed to a worldwide financial crisis.

"2008 showed us that bond ratings can give people a false sense of security," said Mark MacQueen, who helps oversee $7.5 billion in debt at Sage Advisory Services Ltd. in Austin, Texas. "I don't put a lot of weight in the ratings."

Insurance regulators may move to place less emphasis on the ratings of the big three firms. Yesterday, the National Association of Insurance Commissioners approved Realpoint LLC to evaluate commercial mortgage-backed securities. The NAIC said it is reviewing whether to create a non-profit bond-rating firm.

Bar 'Always Moving'

"The fundamental issue is if the bar is always moving, that makes it very difficult," Connecticut insurance Commissioner Thomas Sullivan said in a telephone interview. "Magically overnight, what we thought was AAA is no longer AAA. That's a big problem."

David Teicher, managing director at New York-based Moody's, said in prepared remarks the company has been concerned that the use of ratings for the oversight of regulated entities "can adversely affect the behavior of market participants" and regulators.

"We have learned hard lessons," said Grace Osborne, managing director at S&P, in prepared remarks. "We, along with many other market participants and regulators, never expected such severe, negative performance in the housing and mortgage markets."

Fitch group managing director Keith Buckley said ratings "have been used constructively" in a regulated environment. "From a regulatory point of view," he said in prepared remarks, "the question of what would be used in place of credit ratings is rarely answered satisfactorily."

Regulations

Regulators such as the Securities and Exchange Commission use "nationally recognized statistical ratings organizations" to judge the safety of bonds held by insurance companies or money market funds. S&P, Moody's and Fitch are the largest such rating companies. They'll be represented at the Maryland hearing today, as will Dominion Bond Rating Service Ltd., the NAIC said in a statement last week.

Sullivan is a member of the NAIC's rating working group. James Wrynn, New York's insurance commissioner, and Michael McRaith of Illinois are also on the committee.

Caroline Creighton, a spokeswoman at DBRS, didn't immediately return a call for comment.

Moody's originally declined to participate in the meeting but relented after New York's regulator suggested scaling back the rating firm's authorization if it skipped the session.

Congressional Hearing

The congressional hearing was postponed after the panel obtained an internal Moody's staff memo written by Eric Kolchinsky, a former analyst at the firm, expressing his concern with how the company rated securities, said committee chairman Edolphus Towns. The panel didn't have enough time to incorporate the information into the hearing, he said.

A Moody's representative was invited to the session but didn't come, Towns said.

"They basically didn't show up, they ignored us" Towns said in an interview, referring to Moody's. "I guess they didn't realize we have subpoena power."

The hearing was rescheduled to Sept. 30 at 10 a.m. in Washington.

"Moody's has participated in numerous Congressional and other hearings, and intends to continue the ongoing dialogue it maintains with legislators, regulators and other market participants," the company said in an e-mailed statement. "Moody's will respectfully consider any request to appear at the rescheduled hearing."

Losing Authorization

Insurers can hold certain securities without explicit regulatory approval if those investments are rated by an authorized firm. Losing authorization could mean less business, Hampton Finer, New York's deputy superintendent, said last week.

Congressional leaders should look to reduce the reliance on ratings, New York University Stern School of Business professor Lawrence White said in prepared testimony for the House panel.

"Eliminate all regulatory reliance on ratings," White said in prepared remarks. "The bond information market would be opened to new ideas and new entry in a way that has not been possible for over 70 years."

The ratings companies haven't resolved conflicts of interest and a lack of independence that contributed to the financial crisis and may cause more turmoil, according to Kolchinsky, the former Moody's analyhst.

"Senior management still favors revenue generation over ratings quality and is willing to dismiss or silence those employees who disagree with these unwritten policies," Kolchinsky said in prepared testimony.

Kolchinsky said he worked at Moody's before being suspended for speaking up about alleged securities-law violations at the company. His testimony was to join that of White; Floyd Abrams, an attorney at Cahill Gordon & Reindel LLP; and Joseph Dear, chief investment officer for the California Public Employees' Retirement System.

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