

Partnoy discussion of Spatt paper

Federal Reserve Bank of Atlanta
2010 Financial Markets Conference
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Atlanta, Georgia

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“Big” law questions:

When and how are markets for financial information distorted by regulation?

Might *ex post* standards be superior to *ex ante* rules?

The discussion will consider key issues in the markets for credit information such as the credit rating agencies, financial intermediaries' balance sheets, guarantees of monoline insurers, and suggested changes. It will also consider issues in the markets for information on equities such as stock analysts and asset management.

TOPICS:

- Credit rating agencies
- Bank balance sheets
- Monoline guarantees
- Suggested changes

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Markets for Financial Information

Pure Gov't

USDA

Pure Private

Good
Housekeeping

Financial
Publishers

Siskel & Ebert

Markets for Financial Information

Pure Gov't

Pure Private

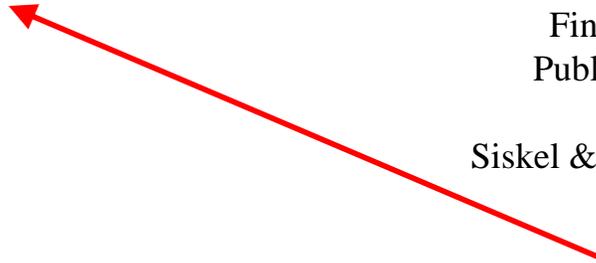
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S&P/Moody's

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“Regulatory License” Theory

Pure Gov't

Pure Private

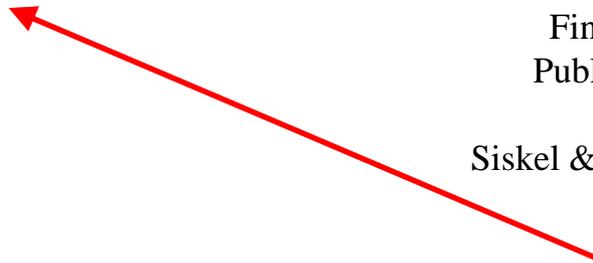
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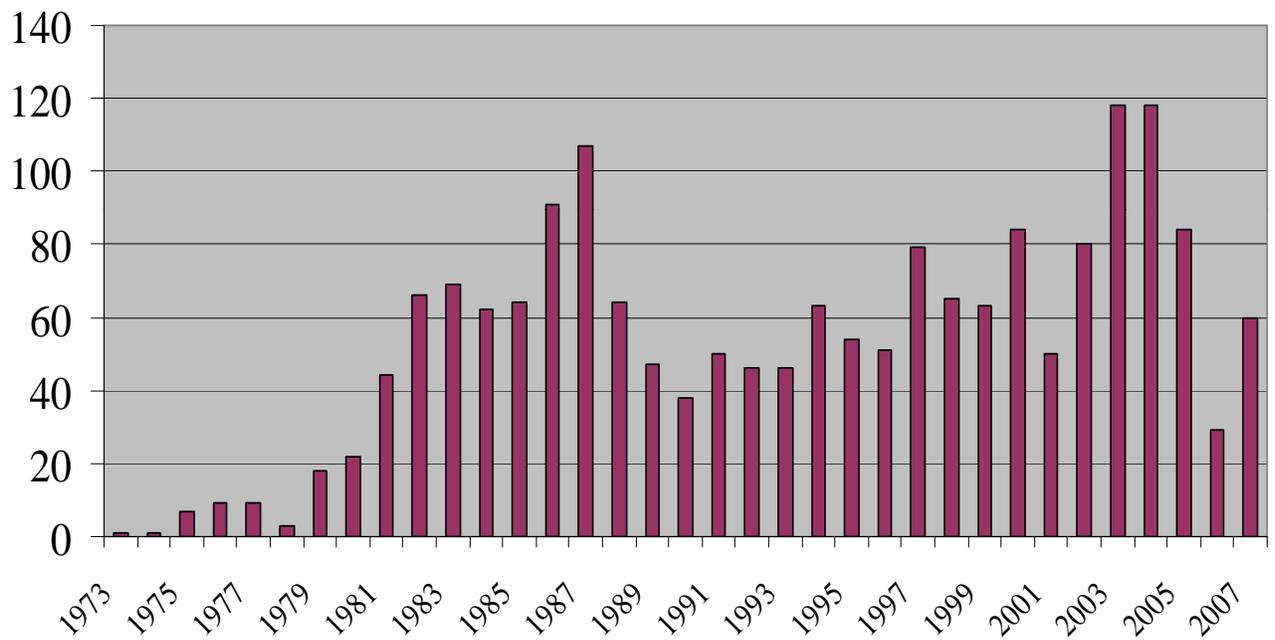
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Annual Federal Agency Decisions Based on NRSRO Status



Spatt at 13-14: “Even during the financial market crisis, some of the approaches used by the Federal Reserve explicitly made reference to certification by the rating agencies.”

SEC Money Market Reform, Release No. IC-29132, March 4, 2010:

(11) Designated NRSRO means any one of at least four ... that: (i) The money market fund's board of directors:

(A) Has designated as an NRSRO whose credit ratings with respect to any obligor or security or particular obligors or securities will be used by the fund to determine whether a security is an Eligible Security; and

(B) Determines at least once each calendar year issues credit ratings that are sufficiently reliable for such use

DOL Exemption, 75 FR 3054, Jan. 19, 2010:

The term "Delivered Security" means a security that is: (1) Listed on a national securities exchange (excluding OTC Bulletin Board-eligible securities and Pink Sheets-quoted securities); (2) a US Treasury obligation; (3) a fixed income security that has a rating at the time of the exchange that is in one of the two highest generic rating categories from an independent nationally recognized statistical rating organization (e.g., a highly rated municipal bond or a highly rated corporate bond)

(Farm Credit, Federal Housing Finance Board)

SEC, Asset Backed Securities Part II, Release Nos. 33-9117; 34-61858, May 3, 2010:

In this release, we are proposing to eliminate the current means of establishing shelf eligibility for an ABS transaction based on the credit ratings of the securities to be issued. Instead, we are proposing to require for shelf eligibility the following:

- [Certification by CEO of reasonable basis to believe assets will produce]
- [Sponsor has skin-in-the-game]
- [Other undertakings]

Spatt at 6: “The phenomenon of ratings shopping raises some interesting questions about the reliability of ratings and whether purchased ratings are relatively high.”

Griffin and Tang (2009)

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A Balance Sheet

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Assets	\$1,884	\$2,188	\$1,938	\$1,889
Liabilities	<u>\$1,765</u>	<u>\$2,074</u>	<u>\$1,797</u>	<u>\$1,746</u>
Equity	\$120	\$114	\$142	\$142



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- Monoline statutory accounting rules required CDO disclosure
- Indenture trustee website showed terms, granularity, performance, monthly cash flows
- **MBIA/Pershing Square**

Christine Richard, *The Confidence Game* (2010)

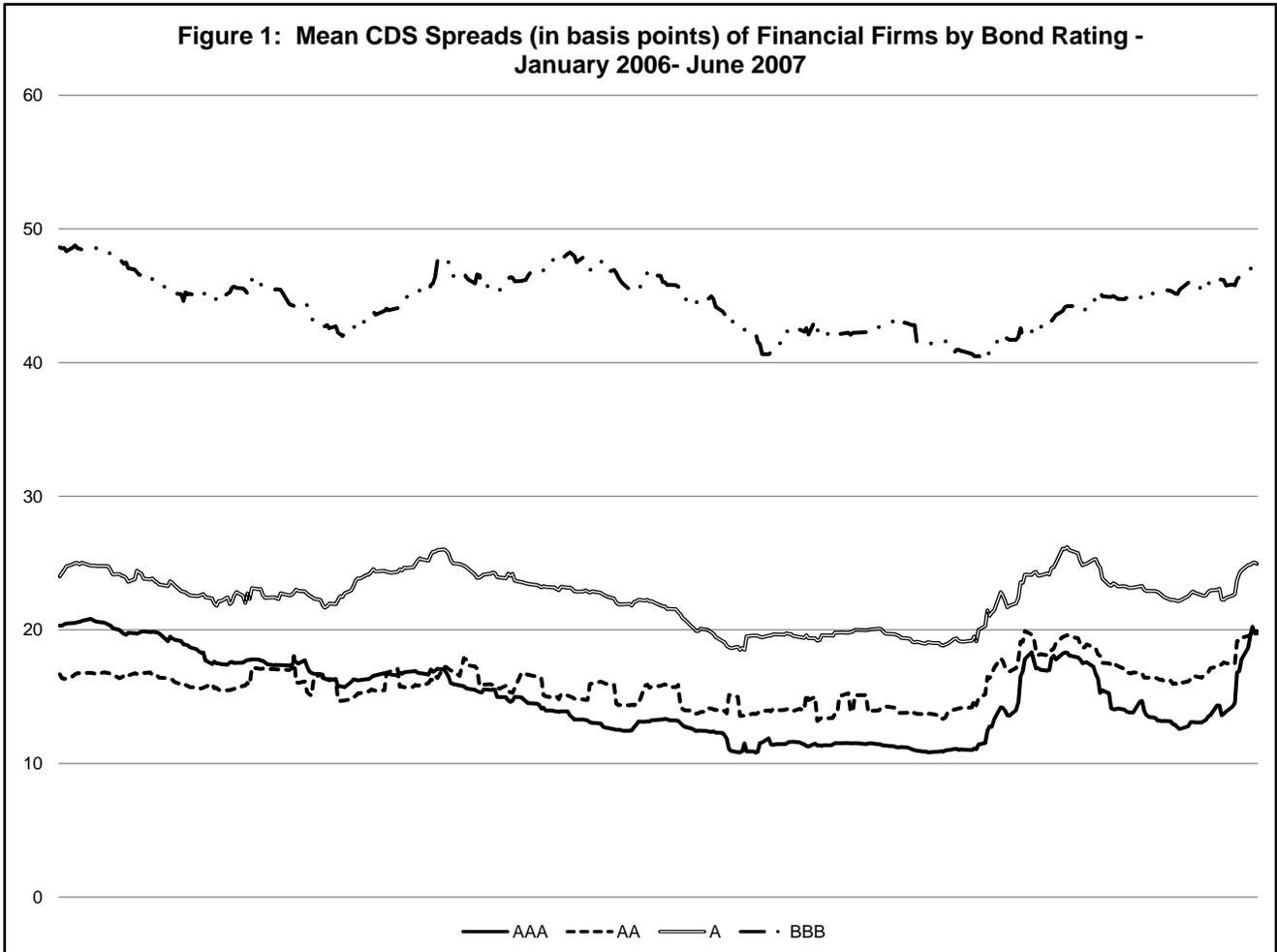
Robert P. Bartlett, *Inefficiencies in the Information Thicket: A Case Study of Derivative Disclosures During the Financial Crisis* (April 2, 2010)

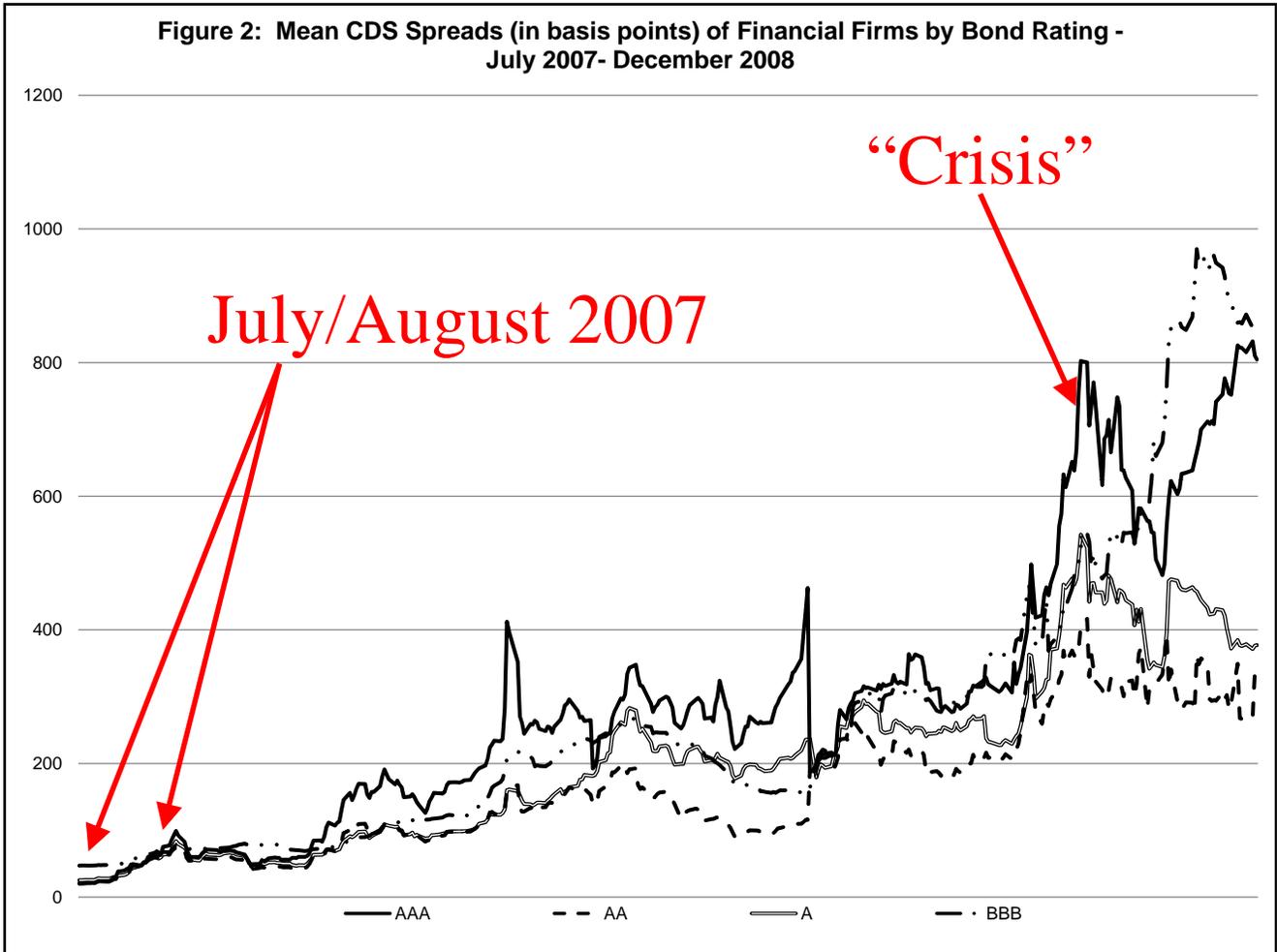
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Flannery, Houston, and Partnoy
(forthcoming U. Penn. Law Rev)

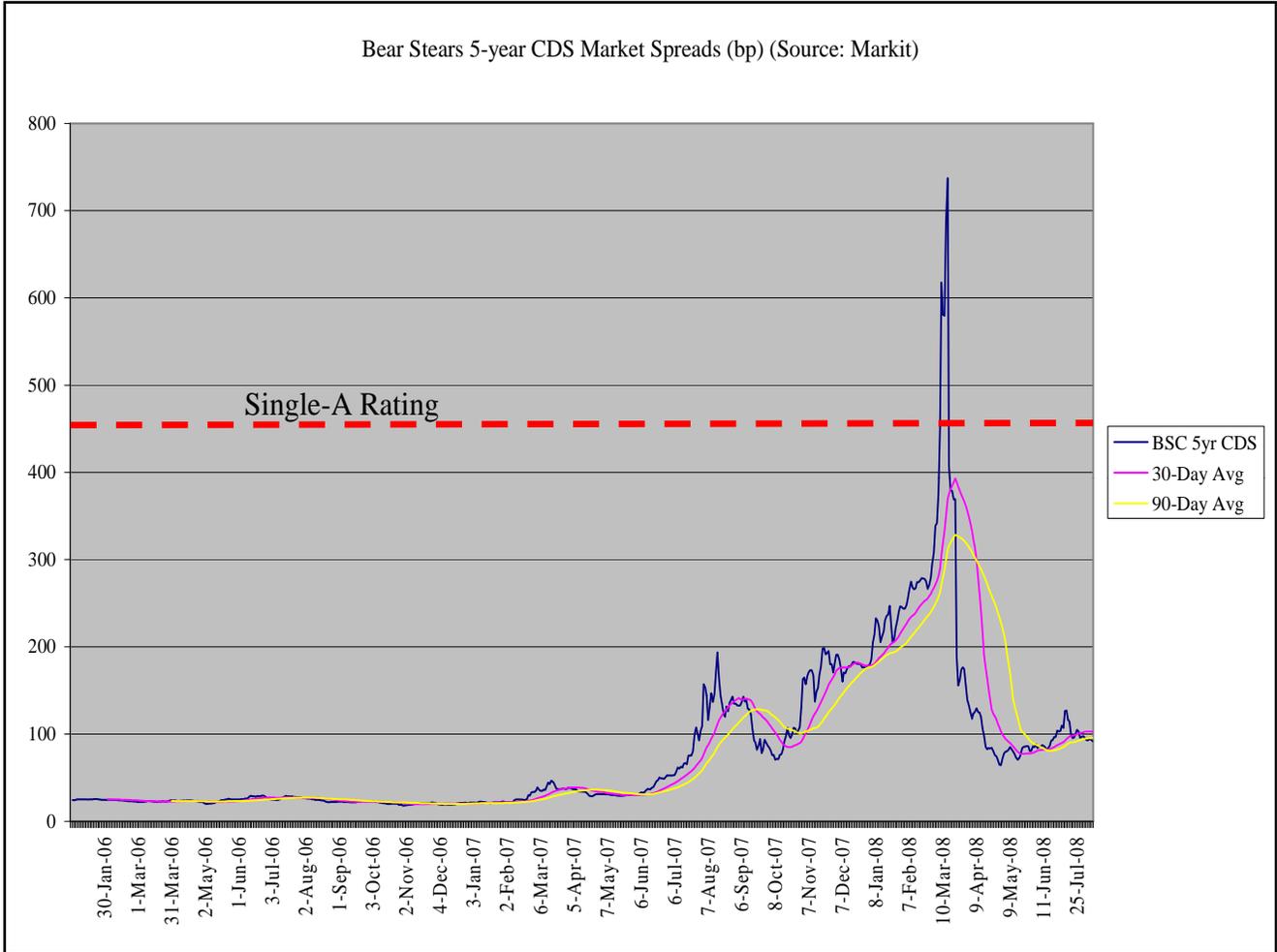
- Markit, Jan 2006-Mar 2009
- Single-name, 5-yr CDS
- End-of day self-reporting,
eliminate outliers
- Banks own Markit
- Aggregate and firm-level





CDS vs. Ratings – Investment Banks

<u>Date</u>	<u>Goldman Sachs</u>		<u>Morgan Stanley</u>		<u>Merrill Lynch</u>		<u>Lehman Brothers</u>		<u>Bear Stearns</u>	
	<u>Spread</u>	<u>Rating</u>	<u>Spread</u>	<u>Rating</u>	<u>Spread</u>	<u>Rating</u>	<u>Spread</u>	<u>Rating</u>	<u>Spread</u>	<u>Rating</u>
2-Jan-06	21	A	22	A	21	A	25	A	24	A
1-Jan-07	21	AA	22	AA	16	AA	21	A	21	A
2-Apr-07	32	AA	33	AA	35	AA	38	A	38	A
10-Jul-07	41	AA	41	AA	42	AA	45	A	57	A
17-Aug-07	81	AA	83	AA	83	AA	150	A	165	A
1-Jan-08	67	AA	99	AA	126	A	120	A	176	A
14-Mar-08	240	AA	311	AA	339	A	448	A	737	A
12-Sep-08	198	AA	265	A	454	A	702	A		
15-Sep-08	324	AA	458	A	343	A	703	A		
16-Sep-08	420	AA	681	A	421	A				
17-Sep-08	596	AA	909	A	530	A				
18-Sep-08	491	AA	875	A	397	A				
19-Sep-08	369	AA	554	A	331	A				
22-Sep-08	282	AA	422	A	271	A				
13-Mar-09	285	A	387	A	428	A				



CDS vs. Equity – AIG

<u>Date</u>	<u>AIG Stock</u>	<u>AIG CDS</u>	<u>ABX A Index</u>	<u>Credit Rating</u>	<u>% Change AIG Stock</u>	<u>% Change AIG CDS</u>	<u>% Change ABX “A” Index</u>
7/19/07	69.66	20.45	90.21	AA			
7/20/07	69.04	21.57	88.39	AA	-0.89%	5.48%	-2.02%
7/23/07	68.85	27.61	87.25	AA	-0.28%	28.00%	-1.29%
7/24/07	67.71	28.42	85.04	AA	-1.66%	2.93%	-2.53%
7/25/07	68.16	29.56	80.61	AA	0.66%	4.01%	-5.21%
7/26/07	66.62	33.77	77.11	AA	-2.26%	14.24%	-4.34%
7/27/07	65.36	44.88	76.28	AA	-1.89%	32.90%	-1.08%
7/30/07	65.21	50.25	76.11	AA	-0.23%	11.97%	-0.22%
7/31/07	64.18	48.40	76.75	AA	-1.58%	-3.68%	0.84%
8/1/07	64.57	64.44	76.75	AA	0.61%	33.14%	0.00%

Liability – First Amendment

Amendment I. Freedom of Religion, Press, Expression. Ratified 12/15/1791.

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