SEC considers civil case against Egan-Jones, an independent CRA

By Miklos Sarvary

Egan-Jones is a relatively young, independent credit rating agency (CRA), one of few such institutions where investors pay for the agency's services not the institutions whose securities are being rated.

As I have written many times before, this difference is important as it has been shown that the conflict of interest so fundamental to traditional large CRAs (like Moody's, Standard & Poor's, etc.) has been one of the reasons for the recent financial crisis and previous stock market bubbles.

I am not sure what the charges are (according to the April 20, 2012 issue of the WSJ they concern the provision of misleading information about the number of ratings provided and the amount of time Egan-Jones performed such ratings) but the possible consequences may essentially mean the (temporary) suspension of Egan-Jones' license as a CRA.

As we have no details about the evidence it is not possible to decide whether the SEC is right or wrong. Nevertheless, I find the case extraordinary. Despite broad criticism of the leading CRAs and their obvious role in the financial crisis no case was ever brought against them. Conflict of interest together with the lack of competition have been clearly identified as the main issue with the CRA industry, yet the SEC never really went after any of the top three firms, which together control the ratings industry in a tight oligopoly. In this context, making such a strong move against a small, barely 5-year old, independent agency that prouds itself not to be plagued by the fundamental problem of conflict of interest is a major statement and casts doubt on the SEC's willingness to reform the industry. We'll see -the SEC may well have a case. But given its behaviour over the last decades in this matter, and in particular, its incapacity to foster competition I see little hope for fundamental change.

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