



Help or hindrance?

Market participants divided over SEC rule 17g-5

The US SEC's rule 17g-5 has been met with compliance on the part of rating agencies (SCI passim). However, other market participants remain divided as to its benefits.

Under rule 17g-5, as of 2 June 2010, all registered NSROs will be prohibited from issuing or maintaining ratings on structured finance products unless the arranger makes all information available to one NSRO available to all others through a password-protected site. Both Moody's and Fitch have issued statements detailing their compliance with the new rule.

Ron D'Vari, ceo of NewOak Capital Management, explains the rationale behind the new rule: "The SEC is hoping to reduce conflicts of interest and create greater transparency. This will subsequently result in a more level playing field."

"Essentially, it's all about freedom of information," adds Rob Ford, partner and portfolio manager at TwentyFour Asset Management. "All information that issuers make available to the rating agencies they will also have to make public."

He explains: "So theoretically if, in order for the agency to complete its rating process, an issuer makes more information regarding a new issue available to the rating agency than it would normally make public, then in future they will also have to make that information public. Equally, any information that they continue to make available to the rating agency in order to maintain the ratings, they will have to make public."

Furthermore, Ford points out that should any rating agency that does not rate a particular deal wish to do so, they will have the same information as the public. While in theory this could lead to a more objective opinion from a rating agency that is not paid by the issuer, he remains unconvinced by the argument.

"Why would a rating agency go out of their way to do all of the work to rate someone's deal when they're not being paid to do it?" Ford asks. "As the majority of the deals are rated by the three main rating agencies, any potential new competitors would need to have a big alternative incentive. It might make sense on large Master Trust issues, but far less so on stand-alone deals."

He continues: "What it may end up being is a time-consuming inconvenience for issuers, which ends up having absolutely no effect at all."

A chief concern among market participants is that the inconvenience caused to issuers in complying with rule 17g-5 may deter new issuance altogether. Ford points to the hurried second Fosse RMBS deal of the year – which came to the market soon after the first – as evidence of issuers acting now before the rule's 2 June commencement.

"It is an issue for potential or prospective issuers," he says. "Santander has come back to the market very quickly after its previous deal and there is market speculation that this is partially predicated by the SEC rule."

However, D'Vari disagrees. "Ultimately the rule shouldn't hinder new issuance," he says. "It will build investor confidence as it reduces the previously cavalier approach to securitisation and creates greater accountability."

He adds: "Although some securitisation professionals may feel the new rules slow the process unnecessarily, there are many that feel the added transparency and standardisation will actually help the market to gain more credibility and add to the ultimate liquidity and market expansion."

Ford agrees that from an investor point of view the rule may be beneficial, as it "does give them the opportunity to access information, particularly documents like swap agreements, which are not normally publicly available".

However, he adds: "But, aside from that, both the ECB and the Bank of England are working hard on increasing the amount of information transparency anyway and moreover they're trying to do that in such a way that the information will be far more standardised, which means that comparison will be much easier – that's not something that's covered by 17g-5."

D'Vari also notes the need for a more standardised approach to bringing transparency to the market. "We should have one global system for information," he says. "Investors should know what the data fields are and who has provided them, and how much confidence they can put in it. The SEC, ECB and BoE should coordinate through an industry panel so everybody signs on."

"At the end of the day, if an issuer wants to get an issue done, then they'll get it done," says Ford. "Thus far, we've only had issuance from very big names and they are probably realising that they are going to have to do a lot more work in terms of standardising information and making information available."

He concludes: "In the medium term, they were going to have to do this anyway, but now they'll have to do it sooner rather than later."