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Re-thinking Credit Rating Agency Liability: A Review of the Legal fiction

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Abstract

The Dodd Frank Act of 2010 (DFA) was the legislative response by the US Government to the Global Financial Crisis of 2007. DFA's rescission of Rule 436 (g) of the Securities Act of 1933 - the exemption from liability clause - was the response to the post-crisis perception that credit rating agencies were insufficiently constrained by reputational risk considerations and consistently failed to provide high quality and accurate credit ratings as a consequence of the immunity they enjoyed and the regulatory reliance placed on ratings, as well as the conflicts of interest that they faced. This paper investigates whether the market failure event that occurred in the Asset Backed Securities market immediately after DFA was signed into law on July 21, 2010 was due to real economic concerns held by rating agencies about operating under a liability regime or whether it was merely an act of brinkmanship on the part of the rating agencies. The paper also predominantly examines US case law to identify the dilution of the freedom of speech defence in state courts, the conflict of interest issues and the legal challenges faced by plaintiffs when bringing a lawsuit against credit rating agencies, and proposes a novel co-pay and capped liability model to address the concerns of both credit rating agencies and investors.

Keywords: Credit Rating Agencies, Dodd-Frank Act, Financial Regulation, Liability Regime