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**President James Bullard Addresses
Questions on Regulatory Reform Proposals
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Does the credit rating system need reform?

This is another problem I don't think we're really addressing is the rating agencies. It's a broken model. Even the people at the rating agencies, when they went to testify before Congress, they said it was a broken model. The way it works is if you've got a new security and you want to get a rating, you go to the rating agencies and say, "I want an AAA rating on this." And they say, "I won't give it to you." You say, "Well, okay, what do I have to do. Do I have to change it around? Plus, I might go to your rival and get the AAA rating from your rival. So what do I have to do to get the AAA rating?" And who's paying the bill? It's the person that needs the rating. So it's the wrong model.

How you can get that to work better, I think you might be able to design things that would work better. But I guess what I've learned about this is the rating system is so ingrained in the way financial markets work, because you've got pension funds and stuff, they can only buy AAA, so they can't go off and say, "I'm just going to use this other rogue" — some private sector upstart that's starting to do ratings or something. They can't do it, because they're constrained by legislation about what they can do. This is a terrible problem, I think,

that I'm not really seeing how we can fix this. I do think that people are trusting the ratings a lot less than they used to, which is probably helpful.

I think that what the rater does is the rater says, "I look at your security today, and I give it a AAA rating, and then as the performance of the security declines, I'm just going to ratchet my rating down and track it down." Well, that's not really very helpful, right? What you want is you want to say at this point, "I think it's going to perform like crap out here, so I'm going to give it a low rating today." But that isn't what they do. They say, "I'll give it a high rating today, and then as performance deteriorates, I'll track it all the way down to BBB or whatever." I think that that part is just not very useful, and it's all wrapped up with the fact that in all these legislation — around the 50 states and around the countries — all says I have to invest in certain grades of securities, and so that's making everybody seek out these high ratings.