S&P Warns on 15 Euro-Zone Nations
Ratings Firm, Criticized for Laxity During Financial Crisis, Cites 'Systemic Stresses' in the Region

By JEANNETTE NEUMANN and LAURENCE NORMAN

Monday's euro-zone downgrade warning by Standard & Poor's Ratings Services is a muscular move by a firm that was pilloried for its supposed laxity in the financial crisis.

Standard & Poor's late today put 15 nations of the euro zone on "credit watch negative," which signals a downgrade within 90 days has 50-50 odds. Michael Casey has details on The News Hub.

S&P put the long-term sovereign-debt ratings of 15 euro-zone nations, including struggling Italy and Spain, on negative watch. That typically means there is at least a 50% chance of a downgrade within 90 days, but the firm said Monday that it expected to announce any rating changes "as soon as possible" following this week's European Union summit, where policy makers are expected to lay out plans to enforce stricter budget rules.

An S&P spokesman confirmed that Monday's move was the most countries the firm has put on credit-watch negative at one time. S&P said the long-term ratings on Germany, Belgium, Austria, Finland, Luxembourg and the Netherlands aren't likely to fall by more than one notch, if at all. But it flagged a potential two-notch downgrade for France and other euro-zone nations.

S&P appears to view the summit as a "make or break" event for the euro zone, said Kathy Jones, a strategist for Charles Schwab & Co.

Some investors warn that the threat of lower ratings could intensify market pressure on stretched government borrowers such as Italy. Its 10-year bond yield soared last month above a market pain point of 7%, before retreating in the past week.

"The timing is bad," said Douglas Coté, chief market strategist for ING Investment Management. "The trajectory was positive for fixing the euro zone" before Monday's action, he said.

In a statement, an S&P spokesman said, "If our opinion of creditworthiness changes it is our responsibility to call it as we see it, without fear or favor and without regard to political expediency."

The firm said in its report Monday that the move was "prompted by our belief that systemic stresses in the euro zone have risen in recent weeks to the extent that they now put downward pressure on the credit standing of the euro zone as a whole."

S&P and its chief rival, Moody's Investors Service, have been criticized for assigning overly optimistic ratings to mortgage-linked securities that later imploded during the financial crisis. The rating firms have also faced scrutiny as the euro crisis has intensified and on Monday, some investors questioned S&P's move. "It does seem as though they are being particularly aggressive in terms of their ratings changes," said Ms. Jones of Charles Schwab.
Moody’s declined to comment Monday on S&P’s move.

The European Commission has sought to push back against the rating firms’ downgrades this year, with commission officials criticizing a series of rating moves and questioning in particular the motives behind the timing of some decisions.

Last month, the commission published a third round of proposed regulation of the industry, including efforts to tighten oversight of the ratings firms’ methods and to force companies to rotate the firms they use. But Internal Markets Commissioner Michel Barnier was forced to shelve at the last minute a proposal that would have allowed the EU’s main supervisory agency to suspend the ratings firms from issuing sovereign ratings if a country was in talks on a bailout. Those proposals still are awaiting debate by member states.

The commission also promised to ensure lessons would be learned from an incident in which S&P erroneously announced it had downgraded France’s triple-A-rated sovereign debt, saying that this underlined investors’ overreliance on a small group of dominant ratings firms.

That episode—along with S&P’s controversial August downgrade of the U.S.’s triple-A rating—has increased scrutiny of the firm.

The Securities and Exchange Commission is probing possible insider trading within S&P and by investors ahead of its downgrade of the U.S., according to people familiar with the matter.

S&P has said it has “robust policies” in place to prevent insider trading. The firm has also said that it is in "regular communication" and cooperates with inquiries made by regulators.

S&P has continued to face criticism of its downgrade of the U.S. But after the failure of the so-called supercommittee in Congress to agree to budget cuts, some investors said the firm’s reasoning was prescient. That failure was triggered by the same kind of political gridlock that led S&P to cut the U.S.’s rating amid concerns that lawmakers aren’t able to effectively tackle the country’s growing debt.

Since then, S&P has had at least two additional—albeit less high-profile—errors. On Nov. 16, S&P said it had assigned a B-plus rating to Ukrainian bonds that don’t exist. Two days later, S&P said in a statement that it “corrected this error and removed all references to these notes and these ratings.”

On Nov. 17, S&P erroneously said in the headline of a report that it had upgraded Brazil’s rating to triple-B-minus—the rating the country already had. S&P later sent out a report with the correct headline—that it had upgraded Brazil to triple-B.

Despite the controversy attached to many of the firm’s moves, there are questions about how much ratings actually matter in the market. The yield on the 10-year U.S. Treasury note, for instance, has dropped to around 2.04% recently from 2.58% in the days before the S&P downgrade.

“What the markets have told you is that maybe S&P’s sovereign ratings don’t matter that much in terms of pricing,” said Bonnie Baha, head of global developed credit at DoubleLine Capital LP.

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