

*Prepared, not delivered*

Opening Statement  
**Chairman Michael G. Oxley**  
**House Financial Services Committee**

**Subcommittee on Capital Markets, Insurance, and  
Government-Sponsored Enterprises**

**Reforming Credit Rating Agencies:  
The SEC's Need for Statutory Authority**

**April 12, 2005**

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Good afternoon. I would like to commend Chairman Baker for holding this important hearing, our third on this subject in the past two years.

Credit ratings serve a vital function in our capital markets system. That is why we need to take very seriously all of the concerns regarding the role and performance of rating agencies and the SEC's regulatory approach that have been raised in recent years.

As a matter of first principles, I remain unconvinced of the necessity for a governmental role in determining which ratings firms deserve a seal of approval. Would it be appropriate for the government to also recognize some brokerage firms for issuing "reliable and credible" stock recommendations? Not a perfect parallel perhaps, but it does underscore the government's unusual, unintended, and arbitrary role in supervising this industry.

I also question some of the criteria used by SEC staff in making the NRSRO determination. Many commentators have rightly noted the classic chicken-and-egg problem — a firm cannot receive NRSRO status without being nationally recognized but how can a firm become nationally recognized without NRSRO status? Another point of major concern is the Commission's ability to monitor the firms' operations once they receive the staff's seal of approval through the no-action letter process.

The SEC's recent proposal defining for the first time the term NRSRO is a modest step in the right direction, but in my view does not go nearly far enough to address the fundamental problems plaguing this industry and the manner in which it is regulated.

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First and foremost, I am troubled by the oligopoly that exists in this industry. Two for-profit agencies control the vast majority of market share. As the Justice Department explained in 1998, the SEC staff requirement that a rating agency be nationally recognized acts as a “nearly insurmountable” barrier to entry for new credit rating agencies. In a free market system, that is not a healthy situation, especially when the industry wields quasi-governmental power. The SEC’s preservation of the national recognition requirement needs to be reconsidered, or at least modified to grant provisional status to those ratings firms that meet all of the other criteria except for national recognition, affording them an opportunity to develop nationally recognized ratings over time instead of being barred outright from entry.

Second, I have concerns about the conflicts of interest which plague the industry. Ratings firms have expanded into new areas which, many commentators have suggested, further compromise their objectivity.

Third, the recent SEC proposal does not address unsolicited ratings. Given the inherent conflicts and evidence that unsolicited ratings tend to be lower, this practice begs for reform, if not outright prohibition.

In prepared testimony to be delivered later today, the SEC witness will state that the “Commission believes that to conduct a rigorous program of NRSRO oversight, more explicit regulatory authority from Congress is necessary.” I agree.

Based on the problems I have discussed, I believe that, at a minimum, Congress has an obligation to inject some competition into the ratings industry, to make the ratings process more transparent, to reduce the cost and improve the quality of ratings, and to ensure adequate oversight of ratings firms. These reforms would provide enormous benefits to the market participants using these ratings.

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