Written Statement of Rapid Ratings Pty Ltd

Concerning

H.R. 2990, The Credit Rating Agency Duopoly Relief Act of 2005

Before

Committee on Financial Services

United States House of Representatives

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I. INTRODUCTION AND OVERVIEW

Mr. Chairman, I appreciate the opportunity to appear today on behalf of Rapid Ratings Pty Ltd ('Rapid Ratings"). Dr. Patrick Caragata, the Founder, Managing Director and Chief Executive Officer of Rapid Ratings, is out of the country today and requested that I appear in his place. My name is Rick Roberts, and I am an attorney in Washington, D.C., with the firm of Thelen Reid & Priest. From 1990 to 1995, I served as a Commissioner of the United States Securities and Exchange Commission ("SEC"). In a couple of speeches in 1992, I highlighted what I viewed as the potential problems imbedded both in the operations of the current credit rating agencies and in the nationally recognized statistical rating organization ("NRSRO") designation criteria utilized by the SEC. Unfortunately, not much has changed since then, except that the potential problems in the credit rating agency area that I highlighted in 1992 have now been generally identified as real problems.

During the last three years, Rapid Ratings has been actively engaged in filing formal statements in response to regulatory and legislative reviews of international rating agencies in the U.S. and abroad. Its submissions include:

- November 3, 2003: http://www.sec.gov/rules/concept/s71203/rapid110603.htm.
- Nov 8, 2004 response to The International Organizations of Securities Commissions in Madrid http://www.rapidratings.com/pdf/IOSC_compliance_rapid_ratings_corporate_credit_rating_agency.pdf.
- June 8, 2005: http://www.sec.gov/rules/proposed/s70405/rrp060805.pdf.
- July 15, 2005: Letter from Rapid Ratings to Hon. Michael Fitzpatrick, Member, Subcommittee on Capital Markets, Committee on Financial Services, United States House of Representatives, 1516 Longworth HOB, Washington, D.C. 20515 Re: H.R. 2990, the Credit Rating Agency Duopoly Relief Act of 2005.

Rapid Ratings is pleased to offer its testimony today on this important legislation that it believes will introduce competition and additional integrity to the rating process for debt securities and will reduce systemic risk in the market. As I will discuss more fully, the current duopoly, in which two credit rating agencies hold eighty percent of the market share, while a third has fifteen percent, has stymied innovation, prevented evolutionary competition, and left investors with inadequate warnings about major corporate collapses. Resolution of those problems lies in the hands of legislators and regulators. The action of Congressman Fitzpatrick to introduce targeted and enhanced competition would make credit ratings more accurate, protect investors, reduce the possibility of unanticipated credit declines and reduce the potential for systemic risk in our capital markets (see attached Figure 1). In my view, H.R. 2990 is a catalyst for reforms that will greatly enhance the quality of information provided to investors.

It is important to recall why we are here and which factors have motivated H.R. 2990. The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or the "Act"), approved by Congress in response to the corporate scandals at Enron and WorldCom, addressed weaknesses in two key corporate governance areas: transparency and accountability. But, in Section 702 and elsewhere, the Act also emphasized a need for reviewing and improving performance measurement by key market participants, such as securities dealers, rating agencies and audit firms. Section 702 specifically asked for a study by the SEC into:

- the role of the credit rating agencies in evaluating the issuers of securities;
- the importance of that role to investors and to the functioning of the securities markets;
- any impediments to the accurate appraisal by the credit rating agencies of the financial resources and risks of issuers of securities;
- any barriers to entry into the business of acting as a credit rating agency, and any measures needed to remove such barriers;
- any measures which may be required to improve the dissemination of information concerning such resources and risks when credit rating agencies announce credit ratings; and
- any conflicts of interest in the operation of credit rating agencies and measures to prevent such conflicts or ameliorate such conflicts.

In essence, the Sarbanes-Oxley Act represented an initial phase of reforming securities markets but also anticipated a second phase in other areas, most notably, from my perspective, the rating agency industry and how it is regulated.

I view H.R. 2990 as a natural evolution of Sarbanes-Oxley that, if enacted, will bring closure to many of the unresolved issues identified in Section 702 of the Act. It has been three years since the passage of Phase 1, and so it is now time for Congress to address Phase 2. Without such reform, our debt securities markets will continue to be prone to systemic risk; and there will be a strong potential for the good work in Sarbanes-Oxley to be undermined unless the two key elements of corporate governance are tied together with performance measurement. The enhanced standards of transparency and accountability (which together are focused on compliance-based inputs) need to be combined with performance measurement (which is focused on outputs), and not just transparency and accountability tied together on their own.

The issue of systemic risk needs to be brought under a bright light as well. Currently, the use of NRSRO rating agency ratings are embedded in hundreds of pieces of legislation, regulation and commercial contracts. The risk arises because these utilizations of NRSRO ratings employ the terms "investment grade" and "sub-investment" grade as if they were the only choices for classifying the risk of assets. In effect, this approach has turned the ratings scale into a binary-choice system, whereby Good (investment grade) Assets are officially approved and Bad (sub-investment grade) Assets are not approved.

As a result, when the rating of a listed company and its securities slip below BBB-, many institutional investors are forced to dump the securities because they are no longer authorized to hold or invest in such assets. This could easily trigger a financial crisis if enough companies are pushed into sub-investment grade territory by NRSRO rating actions. The liquidity crisis would arise because there would be large volumes of securities dumped simultaneously on the market with insufficient, if any, buyers. This whole process is triggered not only by the unthinking use of NRSRO ratings triggers, but more particularly by the absence of a transition phase between investment grade and sub-investment grade, and the absence of early warnings from the current NRSROs in major corporate collapses.

Such a new category would be called borderline investment grade and would cover at least two rating notches (BB+ and BB) where the probability of default is still modest. This low probability of default underlines the short-sightedness of a binary choice system that forces the dumping described above. The way the new system would work is that companies would be required to dispose of non-investment grade assets over time, rather than all at once (see attached Figure 1). Thus, I strongly recommend that H.R. 2990 be amended to direct the GAO to review the issue of systemic risk embedded in credit rating the markets.

II. RAPID RATINGS

Rapid Ratings was founded in 1997 and is an independent global corporate credit rating agency headquartered in Australia, with offices in Australia, New Zealand, Singapore, the UK, Canada and the U.S. Rapid Ratings is currently licensed by the Australian Securities & Investment Commission as a credit rating agency to provide financial advice to wholesale and retail markets. Rapid Ratings anticipates that it will file an application seeking to obtain designation as an NRSRO with the SEC in the near future.

Using proprietary software, Rapid Ratings rates approximately 15,000 listed companies globally, including 7,000 in the U.S. Its core business model is to license its ratings information and related analysis to investors. Rapid Ratings' primary clients are institutional investors, private banks, fund managers, accounting firms, brokers and financial advisors, all of whom use its ratings to assess the financial health of companies in their clients' portfolios so as to minimize the risk of big negative surprises such as Enron, Parmalat, *etc*. Hence, Rapid Ratings follows the original rating agency model of being paid by subscribers rather than by issuers of securities. Moody's, Standard & Poor's ("S&P") and Fitch began to shift away from the subscription model as the concept of NRSRO status was introduced in 1975 by the SEC, following debate about reforming the debt markets in the aftermath of the collapse of Penn Central in 1970.[1]

Unlike current NRSROs, Rapid Ratings' credit ratings assess the financial health of an institution based on industry-specific quantitative models. Rapid Ratings' system utilizes twenty-four industry specific models that analyze the audited financials of each company relative to its global peers, using a global database of more than 300,000 companies with more than thirty years of data. The ratings are derived solely from publicly disclosed financial statements.

Rapid Ratings' track record for anticipating the collapse of major companies is excellent. Rapid Ratings assessed GM's credit strength as being well below investment grade when commercial coverage of GM began in early 2004, and back testing shows that GM became sub-investment grade in 2000. In contrast, S&P and Moody's downgraded GM to non-investment grade in May 2005. Rapid Ratings assessed Delphi's credit risk as well below investment grade when it first began commercial coverage in early 2004, and back testing showed that Delphi had been sub-investment grade since 2001, and distressed since 2003. In contrast, S&P and Moody's downgraded Delphi to non-investment grade in late 2004.

Rapid Ratings also anticipated Air Canada's December 2003 default in 2001, Air New Zealand's October 2001 default in 1999, AMP's (Australia) April 2003 capital crisis in 1999, and Stelco's (Canada) January 2004 default in 1999. In addition, back tests of its quantitative models establish that Rapid Ratings would have also predicted the collapse of Enron and Parmalat four to six years, respectively, before current NRSROs took action, as well as predicted the largest corporate collapse in Australian history (HIH Insurance) in 2001 by five years (1996).

[1] "…In the 1970s, the major rating agencies including Moody's began the practice of charging issuers as well as investors for rating services. The rationale for this change was, and is, that issuers should pay for the substantial value objective ratings provide in terms of market access. In addition, it was recognized that the increasing scope and complexity of the capital markets demanded staffing at higher levels of compensation than could be received from publication subscriptions alone."
http://www.moodys.com/moodys/cust/AboutMoodys/AboutMoodys.aspx?topic=history

III. CURRENT APPROACH TO RATINGS AND IMPLICATIONS

Since the NRSRO concept was created in 1975, it has become a regime with significant long-term implications.[2] The original intent of the SEC regulations in 1975 was rather narrow: "to provide a method for determining capital charges on different grades of debt securities under the Commission's net capital rule for broker-dealers, Rule 15c3-1 under the Exchange Act. . . ." Over time, however, the importance of the NRSRO designation has far eclipsed its parochial origins. Today, numerous pieces of legislation and regulation incorporate NRSRO references and requirements,[3] with the result that most financial institutions in the United States (banks, insurance companies, mutual funds, pension funds, *etc.*) are required by law to incorporate NRSRO ratings in their business decisions. As a consequence of the current rating scheme, the

[2] John Moody invented credit ratings when he began issuing letter rating symbols to railroad debt in 1909. Moody began rating corporate bonds in 1913 and by the end of that year Fitch Publishing Company was founded. Poor's Publishing, which traced its roots to financial manuals first published in the 1860's, began rating corporate bonds in 1916. Thus was the credit ratings business born—from publishing firms selling subscriptions of statistically-based analysis to investors. As Moody's puts it in its company history, "Then -- as now -- Moody's ratings were based on public information and assigned without the request of issuers." Yet much has changed since then and the credit ratings business today is very different from its origins.

Fast forward to the 1970's, when the NRSRO concept was first created. After the crisis created by the Penn Central bankruptcy in 1970, investment bankers began to use credit ratings in debt offerings to supplement their internal due diligence. As usage increased and the importance of the credit ratings escalated, the publishing firms decided to charge debt issuers for assigning ratings to new debt. However, at the point that the market began to rely heavily on credit ratings, they were primarily statistically driven from publicly available information.

New ratings methodologies evolved once the decision was made to charge issuers for ratings. These are analyst intensive, in part to provide safeguards against the conflicts inherent in charging fees to the issuers being rated. A minimum of two analysts were assigned to every issuer and ratings are reviewed and approved by committee. These methodologies have worked well to provide safeguards against conflicts, but they can also be an impediment to timely action.

In 1975, the SEC, looking for a convenient metric to define net capital rules for broker/dealers, decided to use credit ratings as a proxy for the risks associated with debt securities, and fashioned the NRSRO definitions around the nascent issuer-paid business model. The SEC had no inkling of how widespread the usage of the NRSRO term would become. If it had, it probably would have given more thought to the NRSRO concept, something it is now trying to do. "Nationally recognized" was a convenient way of short-cutting the task of actually defining what makes a good credit rating. "Statistical ratings" is a vestige of the original methodologies which were largely quantitative.

[3] http://www.sec.gov/rules/concept/s71203/rapid110603.htm#P48_2869#P48_2869.

NRSROs have tremendous influence and market power, both domestically and globally, and have generated tremendous returns for their investors. [4]

Although the SEC has proposed the adoption of a rule defining NRSROs, currently such status is conferred by means of a staff no-action letter. Moreover, that gateway to NRSRO designation is very narrow – if not entirely closed. Over the past thirty years, only a handful of organizations have achieved NRSRO designation.

There are currently five key factors that the SEC staff uses to assess before assigning NRSRO status:

1) Whether the company is nationally recognized as an issuer of credible ratings by users of securities ratings;
2) Whether the company maintains substantial financial resources to operate independently of the companies it rates, more than ample professional staffing, and an organizational structure that ensures its ability to produce credible ratings;
3) Whether the company has sound procedures and processes in place that enable it to support its ability to produce credible ratings;
4) Whether the company has access to senior management of the companies that it rates on a year-round basis; and
5) Whether the company has in place sound procedures to prevent the misuse of non-public information obtained as part of the ratings process.

According to the SEC, however: "The single most important criterion is that the rating agency is widely accepted in the U.S. as an issuer of credible and reliable ratings by the predominant users of securities ratings."

[4] http://www.sec.gov/rules/concept/s71203/rapid110603.htm#P51_4819#P51_4819.

As applied by the SEC, the U.S. Department of Justice has noted that, historically,[5] the NRSRO criteria act as a barrier to entry, and in a catch-22 manner. A new rating agency cannot obtain national recognition without NRSRO status, and it cannot obtain NRSRO status without national recognition. The effect of this catch-22 has been to preserve a duopoly that has thwarted competition and innovation.

I believe that additional competition will ensure earlier warnings to the marketplace of potential problems, greater accuracy in ratings, broader coverage of issuers, lower costs to issuers and investors, and greater independence and objectivity. Greater competition is likely to reduce prices for both buy-side and sell-side users of ratings. At the same time, multiple views based on different methodologies will result in a more critical analysis of borrowers that will more efficiently allocate capital, reduce informational disparities among investors, and reduce surprises that produce systemic shocks.

IV. PROBLEMS WITH CURRENT APPROACH

Objectivity, independence and integrity are necessary to ensure the validity of the ratings process. Current NRSRO criteria were designed for rating agencies with an issuer-paid business model. Despite their origins of being paid largely by subscribers, since NRSRO status was introduced in 1975, the largest rating agencies have been increasingly (and now predominantly) paid by issuers of debt to rate those parties, which I refer to as a Type 1 Model. This was perhaps one of the unintended consequences of the creation of NRSRO status. Type 1 rating agencies employ highly skilled and highly paid people that go onsite to acquire non-public information to rate companies. New generation rating agencies, such as Rapid Ratings, have an entirely different business model (Type 2 Model).[6]

[5] http://www.sec.gov/rules/concept/s71203/rapid110603.htm#P69_8177#P69_8177.

[6] The current NRSRO guidelines have fossilized a specific ratings process and have discouraged innovation even by current Type 1 NRSROs. Despite acquiring Type 2 firms such as KMV and Algorithmics, firms with innovative quantitative credit scoring models, current Type 1 NRSROs have been reluctant to integrate these capabilities into their traditional ratings process, preferring instead to offer them as supplemental capabilities. Under the current

New generation rating agencies are paid by investors or other third parties (banks, insurance companies, investment funds, pension funds, large creditors, *etc.*) to rate second parties (listed and/or unlisted companies and their securities) and use only publicly available information. Type 2 rating agencies also typically use software rather than analysts. Thus, in the Type 2 Model, there may be no contact between the rating agency and the companies it rates and thus little potential for conflict of interest. Rating agencies that follow a subscription business model do not need to manage the conflicts of interest that arise when the issuer being rated is also paying for that rating. In assessing eligibility for NRSRO status, it would be unfair to require a Type 2 company to conform to criteria that pertain only to Type 1 companies that have such conflicts.

Once barriers to entry are made less onerous and more balanced, new entrants will bring new ideas and a refreshing level of competition to the industry. Eventually, if they have the right technology and are provided a level playing field so they can compete on equal terms, Type 2 rating agencies will expand ratings coverage and improve ratings' timeliness and accuracy because of their ability to process tens of thousands of companies at low cost. That is the critical catalyst for enhanced and sustainable competition. Just like Henry Ford promoted the development of "a car for every family", the Type 2 rating agencies will be able to deliver "a rating for every company".

Currently, the Big Three rating agencies only rate between 10% and 25% of listed companies globally and less than 0.1 % of registered companies in each major securities market because of the cost and expertise constraints they impose on the markets. Rapid Ratings can rate all companies for which it obtains audited financials, and its current low-end capacity level is several thousand companies per day.

NRSRO guidelines, it is preferable for a Type 2 firm such as KMV to be acquired by an existing Type 1 NRSRO because designation as a stand-alone entity would be difficult if not impossible.

V. RECOMMENDED SOLUTIONS

Our recommended approach, and one that we have expressed to the SEC, would be to reduce the weight placed on the existing input-based criteria, such as access to non-public information, and focusing instead on output criteria. In our view, the output criteria should be based on: (a) the track record of the rating agency in predicting individual corporate declines and collapse; (b) the track record of the rating agency in anticipating corporate turnarounds; and (c) the ability of the rating to anticipate corporate demise ahead of the share price. If a rating agency cannot beat the share price in anticipating corporate collapse, it is questionable if that agency is adding any new information to the market. Typically, the traditional Type 1 rating agency ratings lag the share price by 1-3 years in anticipating the demise of companies.[7]

VI. THE CREDIT RATING AGENCY DUOPOLY RELIEF ACT OF 2005

Rapid Ratings believes H.R. 2990 would achieve many of the goals that are necessary to promote greater efficiency in the debt markets. It would remove most of the current restrictions, instituting a registration process for rating agencies that have been in business for more than three years. The legislation would substitute "Registered" for "Recognized" in the NRSRO acronym. It also would permit quantitative firms to be registered and would allow subscription fees to be charged for ratings by not requiring wide dissemination of ratings at no cost.

This legislation goes a long way toward removing the barriers to entry created by the current regulatory standards, while assuring the integrity of the rating process by providing credible market-based standards. My specific comments to the bill are outlined below.

[7] Sources include: Pinches, George E. & J. Clay Singleton, 1978, The Adjustment of Stock Prices to Bond Rating Changes, vol. 33 Journal of Finance pp, 29-55 at 39. Odders-White, Elizabeth R. and Mark J. Ready, 2003, Credit Ratings and Liquidity, Department of Finance, University of Wisconsin. Creighton, Adam, Luke Gower and Anthony Richards , 2004, The Impact Of Rating Changes In Australian Financial Markets, Research Discussion Paper 2004-02 , March 2004, System Stability Department, Economic Research Department, Sydney, Reserve Bank of Australia. Macey, Jonathan R. 2002, Cornell Law School, Testimony before the US Committee on Governmental Affairs, March 20, 2002 , "NRSROs and Investor Protection" and additional research by Rapid Ratings.

A. Definition of a Statistical Rating Organization

As currently written, H.R. 2990 contains two key definitional requirements. First, it requires that the SRO have been in the business, and, in fact, have had as its primary business, the issuance of publicly available ratings for the three prior consecutive years. The definition of SRO specifies that the methodology used by an organization may be either quantitative, such as that employed by Rapid Ratings, or qualitative – or both.

1. Credible Business

In my view, the requirement that a business be credible is an appropriate test that contains two measures: one that examines the organizational and financial resources of the firm, and one that examines the quality and acceptance of its products. In connection with operational integrity – or credibility - I believe that it is important to retain in the legislation the clear statement that the legislation is intended to encompass both organizations that employ qualitative as well as quantitative measures – or a combination thereof, and that are paid by either the issuers or the investors.

Although the SEC has indicated an openness to quantitatively oriented ratings agencies qualifying for NRSRO status, the recently proposed NRSRO definitions are biased against quantitative firms. For example, the SEC notes in its release accompanying the rulemaking, a number of benchmarks, including the experience and training of analysts, number of issues covered by each analyst, and information sources within issuers as determinative of operational integrity. These criteria, and the level of operational funding needed to support the functions, while relevant to qualitative rating organizations (Type 1: paid by issuers), have little relevance to organizations such as Rapid Ratings and other quantitative firms that determine their ratings based on software models and public information (Type 2: paid by investors and other subscribers). In order to assure that a level playing field is provided between the two types of rating organizations, I believe that it is important to retain specific reference to both quantitative as well as qualitative ratings methods and organizations in H.R. 2990, and to include specific reference to Type 1 rating agencies paid by issuers and Type 2 rating agencies paid by subscribers (such as institutional investors). This will ensure that the pre-1975 practice of having ratings largely paid for by investors and other subscribers is revived by new generation rating agencies with new technology and a strong record for providing early warnings to the market.

I also believe that substituting a "credible ratings" requirement in lieu of the current "nationally recognized" or "generally accepted" language is a far more effective standard for judging rating agencies and is one that allows for both a market franchise and the evolution of competition. This criteria, in fact, has been criticized most frequently as being the most anti-competitive language in the current NRSRO definition.

In determining the credibility of a rating agency's ratings, the SEC should focus on independently verifiable statistical measures that support the agency's claim of credible and reliable ratings. As I noted above, output criteria based on: (a) the track record of the rating agency in predicting individual corporate declines and collapse; (b) the track record of the rating agency in anticipating corporate turnarounds; and (c) the ability of the rating to anticipate corporate demise ahead of the share price are more important, objective and reliable evidence than the strength of a brand name that may be recognized as the result of marketing or legacy. No organization will be successful or able to fund operating expenses for any sustained period of time unless it has market acceptance. But there must be a legal and regulatory level playing field to ensure that new NRSRO entrants have the opportunity to gain market acceptance.

2. Public Availability of Ratings

Although H.R. 2990 requires that ratings must be publicly available, it substantially improves upon the current SEC requirements, which require that the ratings be made available to the public for free. By allowing a subscription based business model, and not just a ratings fee model, H.R. 2990 permits additional competition from Type 2 firms such as Rapid Ratings.

B. Registration and Elimination of SEC Designation

I believe that the registration proposal set forth in H.R. 2990 will achieve the purpose of enhancing competition and, at the same time, assuring that the SEC has the power to apply appropriate controls to ensure the integrity of rating organizations. Among the benefits of the proposal are that it provides for a transparent process, sets definite time periods for action, and requires agency action that can be appealed based on objective measures. In addition, I believe that the language of the legislation is broad enough to permit the SEC wide latitude in rulemaking to address any concerns that may develop over time.

C. Filing Requirements

As part of the registration process, applicants would be required to disclose information regarding any conflicts of interest, and its credit rating methodologies, performance measurement statistics and procedures to prevent the misuse of non-public information. Each of these requirements form an ethical and empirical basis by which the SEC and potential users of ratings can measure the integrity and value of the organization offering particular ratings.

VII. CONCLUSION

Designating additional Type 1 rating agencies as NRSROs via a modified NRSRO definition will not necessarily generate sustainable higher competition that will enhance early warnings and reduce systemic risk. The SEC proposed NRSRO definition makes it difficult for rating agencies pursuing innovative business models to attain NRSRO status. Further, if new Type 1 rating agencies enter the market, they are unlikely to take much business away from S&P, Moody's and Fitch because the market has little interest in a fourth, fifth or sixth opinion from a similar business model (*i.e.*, paid for by issuers). Having a third opinion from Fitch has been a very hard sell to the marketplace. So while there is room for a Me 1, Me 2 and Me 3 system, the entry of Me 4 and Me 5 have hardly generated excitement, while the entry of Me 6, Me 7 and Me 8, *etc.*, would create a big yawn.

The real potential for enhancing ratings competition arises with the entry of innovative rating agencies that offer alternate business models. Type 2 rating agencies, which mark to market, use models or software and are paid by the buy-side, offer excellent track records of issuing early warnings, objectivity and independence and broad coverage.

Any reform to the currently restrictive NRSRO criteria raises a concern among some market participants over "ratings shopping," *i.e.*, that issuers would obtain ratings from agencies that offer the most lenient ratings criteria. Performance benchmarks available to the SEC in determining whether an agency provides credible ratings would address this concern. Verifiable statistical measures such as default statistics and rating comparisons on issuers rated jointly by multiple agencies clearly reveal any agency which is systematically an "easy grader". In addition to the tools available to the SEC, there would be reputational risk for any such rating agency among investors. This concern is already addressed in the marketplace, where market pricing mechanisms such as bond spreads routinely "second guess" the credit rating, and would highlight firms that are consistently assigning higher ratings than would be warranted by an issuer's financial condition.

Another concern mentioned with regard to reducing barriers to NRSRO entry involves market confusion. The concern is that an increase in competitors would disrupt debt markets by introducing additional rating symbologies, definitions and methodologies. The reality is that the debt market is largely institutional. Institutional investors already utilize hundreds of sources of equity research without deleterious effect. There are currently over 300 distinct sources of equity research, each with different methodologies, symbologies and track records. The SEC, along with other U.S. regulators, has been actively encouraging additional competition among equity research providers as it has been administering the independent research provisions of the

Global Research Settlement. There is no reason why additional sources of credit research would be any less desirable than additional sources of equity research.

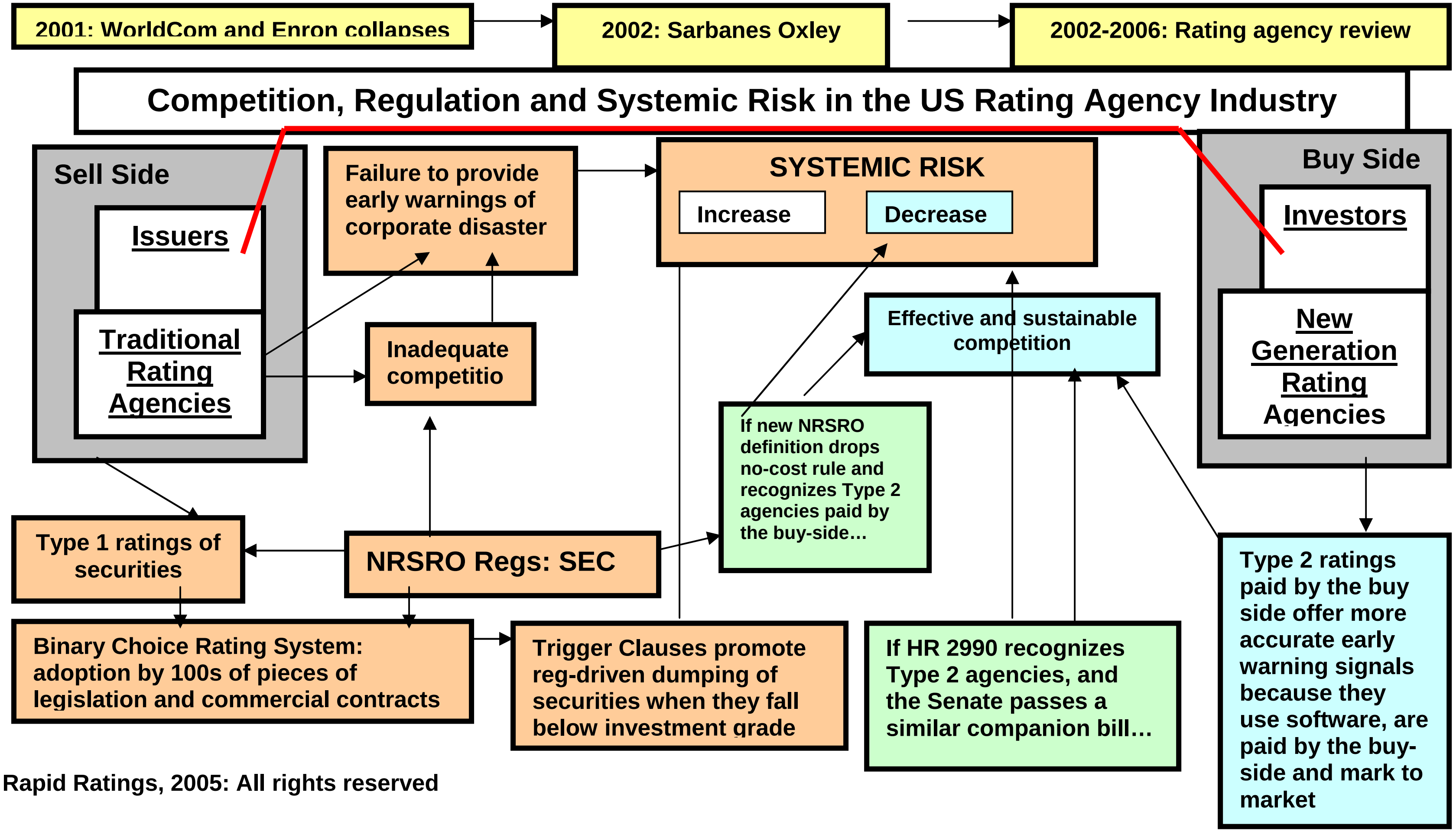
In conclusion, if a level playing field is created to permit rating agencies with innovative business models such as those that mark to market, are based on software and are paid by investors to compete effectively with Type 1 rating agencies (which are paid by issuers), there will be significant benefits to the market, namely:

1) earlier warnings to the market of potential problems,
2) enhanced protection and choice for investors,
3) greater accuracy in ratings,
4) broader coverage of securities and issuers,
5) lower costs to issuers and investors,
6) greater independence and objectivity, and
7) less risk of systemic shocks.

Again, I appreciate the opportunity to appear today before the Committee. In my view, the reduced barriers to entry afforded by H.R. 2990 will provide substantial benefits to the markets and improve the efficiency of the capital allocation process. The global investment community has looked for many years at the U.S. standards for rating agency designation. H.R. 2990, if successful, will provide an enduring, positive effect on global markets because new U.S. legislation and regulations affecting credit rating agencies are studied intensely and are often adopted in other countries around the world. It will also represent a successful complement to the Sarbanes-Oxley Act's reform of our capital markets.

I will be glad to attempt to respond to any questions that you may have at the appropriate time.

Figure 1: Background to the Current Debate About Nationally Recognized Statistical Rating Organizations



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