TESTIMONY OF CRAIG PARMELEE

MANAGING DIRECTOR AND LEAD ANALYTICAL MANAGER FOR NORTH AMERICAN FINANCIAL INSTITUTIONS RATINGS

STANDARD & POOR'S RATINGS SERVICES

BEFORE

THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

UNITED STATES HOUSE OF REPRESENTATIVES

FEBRUARY 2, 2011

Mr. Chairman, Mr. Ranking Member, Members of the Subcommittee, good morning. My name is Craig Parmelee. I serve as a Managing Director and Lead Analytical Manager for North American Financial Institutions Ratings at Standard & Poor's Ratings Services ("S&P"). I am pleased to appear before you today to discuss S&P's ratings on MF Global.

At the outset, I would like to take a moment to speak generally about our credit ratings process and to explain what ratings are and are not intended to convey.

Background Information about S&P

Over the course of its 152-year history, S&P has sought to improve transparency in capital markets by providing independent assessments of the creditworthiness of companies and securities. Investors and other market participants have repeatedly turned to S&P for our view of credit risk and we have established a long track record of providing a valuable, independent perspective. At their core, S&P's credit ratings reflect forward-looking views about the ability and willingness of issuers to meet their financial obligations in full and on time. S&P's ratings are thus expressions of opinion about the relative likelihood that certain events will, or will not, occur in the future. By the same token, S&P's ratings are not recommendations to buy, sell or hold any particular securities, and they are not statements of fact.

S&P's basic process for forming and disseminating credit ratings is well-established. Typically, ratings are the result of both quantitative and qualitative analyses of information that ratings analysts gather from issuers and other third parties. Ratings are not formed by any one analyst, but rather by committees of analysts based on the application of transparent, publicly available ratings criteria. Once a public rating is determined, S&P publishes it in real-time and for free on its Web site, www.standardandpoors.com, typically alongside a narrative providing detailed information about our underlying analysis and often citing the S&P published criteria applicable to the rating. Following publication, S&P's ratings are generally surveilled by S&P analysts and raised, lowered, or reaffirmed as appropriate based on S&P's view of the creditworthiness of the rated company or security over time.

S&P's Criteria for Rating MF Global

S&P's credit ratings on MF Global were formed and disseminated based on S&P's generally applicable policies and procedures and the application of its published criteria for rating financial institutions and brokerage companies. This criteria provides for the consideration of a number of key factors to assess creditworthiness based on S&P's opinion of a firm's business and financial risks, including its diversification, market position, confidence sensitivity, management and strategy, credit risk, market risk, funding and liquidity risks, earnings, capital and financial flexibility. Additional factors that S&P considers include the rated company's capital adequacy, asset quality, financial projections and risk management.

The specific information gathered and reviewed by S&P's analysts in connection with the ratings on MF Global included MF Global's audited financial statements, other public filings, presentations prepared by MF Global management and other information (both written and oral) deemed to be potentially relevant and useful by S&P's analysts in the ratings process. Such information included, among other things, documents describing MF Global's organizational structure, capital profile, risk management policies, and liquidity. MF Global also provided information about its strategic plans related to principal and client facilitation activities. MF Global represented to S&P that the information it provided was accurate and complete

Chronology of Rating Actions and Relevant Events

S&P's Ratings on MF Global from 2007 – 2008

On May 31, 2007, S&P published its first rating on MF Global. This initial rating was 'BBB+,' reflecting S&P's view that MF Global had a "strong franchise." The rating was accompanied by a "stable outlook" based on S&P's view that the company would continue to grow.[1]

S&P's rating remained unchanged until February 29, 2008, when it was downgraded to 'BBB' following an announcement by MF Global that it would incur a $141.5 million loss resulting from unauthorized trading by one of its employees. This downgrade was accompanied by a "CreditWatch Negative" placement, signaling that S&P could lower the rating further based on its ongoing review of the firm's risk management policies.[2] On July 18, 2008, S&P removed the CreditWatch designation based in part on MF Global's implementation of new enterprise risk management ("ERM") initiatives. At this time, however, S&P continued to view the firm's overall risk management as "weak." On December 4, 2008, S&P affirmed the 'BBB' rating but changed its outlook back to "negative," signaling the potential for another downgrade based on MF Global's lower cashflows and a decline in customer payables, among other things.

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1 An S&P rating outlook assesses the potential direction of a long-term credit rating over the intermediate term (typically six months to two years). In determining a rating outlook, consideration is given to any changes in economic and/or fundamental business conditions. Essentially, a positive outlook means that, in S&P's view, a rating may be raised, a negative outlook means it may be lowered and a stable outlook means that a rating is not likely to change during the period.

2 CreditWatch highlights S&P's opinion regarding the potential direction of a short-term or long-term rating. It focuses on identifiable events and short-term trends that cause ratings to be placed under special surveillance by Standard & Poor's analytical staff.

S&P's Ratings on MF Global in 2009

S&P reiterated its 'BBB' rating and negative outlook in reports published on February 25 and September 24, 2009. The latter report was the result of S&P's annual review of MF Global's creditworthiness. This report stated that the firm had experienced significant losses during the first two quarters of 2009 due to lower net interest income, lower trading volumes, lower margin balances and increased expenses. In this September 24 report, S&P also explained that it expected MF Global to continue experiencing lower trading volumes and reduced interest income going forward, which would likely continue to affect its revenue negatively over the upcoming quarters. The report added that, while management planned to increase efficiencies, strengthen risk management, optimize capital and establish a global governance model, S&P would nevertheless maintain its negative outlook on the rating due to the firm's generally weak profitability and various challenges faced by management, including challenges related to risk management.

November 24, 2010 Downgrade

S&P downgraded MF Global's rating on November 24, 2010, to 'BBB-'. This is just one notch above speculative, non-investment grade status and was lower than the ratings of either of S&P's two largest competitors at the time. In the published report announcing this downgrade, S&P stated that MF Global had suffered additional losses in the most recent quarter, attributable again to lower volumes, low interest rates and changes in operating strategy and client behavior. The report stated that the firm's capital levels were, in S&P's view, merely "adequate" and highlighted a number of large charges and write-downs.

The report further noted that MF Global's new CEO, Jon Corzine, had announced a strategy to begin transitioning MF Global from a relatively low-margin traditional commodities broker to a higher-margin broker-dealer, and eventually a full-service investment bank. As stated in the report, S&P understood that Mr. Corzine's strategy would involve taking on more risky proprietary trading positions, rather than merely facilitating transactions for its clients. Although senior management of MF Global informed S&P that this transition would be undertaken at a gradual pace, the November 24 report concluded that the strategy would nevertheless "increase the firm's risk profile." The report further stated that the company's ERM was still "a work in progress that needs to keep pace with the . . . market risk associated with its planned increase in principal and market-making activities."

In this respect, the November 24 report was consistent with S&P's Industry Outlook for U.S. brokerage firms — published nine months earlier in February 2010 — which had stated that "true franchise values" for brokerage firms typically come from "their intermediary role as distributors, trade facilitators, and/or advisers" and that, by contrast, "the more a broker directly provides financing for its clients or holds assets with credit or market risk, the more open it is to outsize losses and a potential downward spiraling of confidence in the firm."

MF Global's intention to pursue a new, more aggressive business plan did not cause S&P to change its usual processes and criteria for forming and disseminating credit ratings. S&P's ratings processes and criteria are generally applicable across the financial institutions and brokerage firms it rates. Thus, the same processes and criteria that underlie the ratings of MF Global were also applicable to ratings of larger firms and other brokerage institutions that may have had even more complicated strategies and business plans. The generally applicable nature of these processes and criteria is critical in allowing S&P to provide apples-to-apples analyses within industries, which ultimately improves transparency in the market.

S&P's November 24 report on MF Global concluded by warning that further downgrades were possible during implementation of MF Global's new strategy, particularly if the company were to experience material principal losses, deteriorating liquidity, or increased leverage.

MF Global's Disclosure of its Repo-to-Maturity Portfolio

MF Global's Form 10K released in May 2011 disclosed that the firm had off-balance-sheet exposure to approximately $6.3 billion of European sovereign debt through so-called re-purchase-to-maturity transactions (the "RTM" portfolio). MF Global also referred to this portfolio in a Form 10Q filed in August 2011. S&P learned of this portfolio at the same time as the general public and had no advance notice of it. Nor was S&P provided specific details about the portfolio until late October.

S&P understands that the RTM portfolio consisted of sovereign bonds funded through scheduled maturity in 2012. Accordingly, the most direct risk presented by this investment was that one or more of the relevant sovereign nations -- Ireland, Italy, Spain, Portugal, and Belgium -- would default during this relatively short time period. Disclosure of the RTM portfolio in May 2011 appeared to cause virtually no immediate reaction in the markets. In fact, in August 2011, more than six weeks after the disclosure, MF Global successfully issued hundreds of millions of dollars of bonds with relative ease, suggesting that investors continued to have confidence in the firm and its prospects. Following disclosure of the RTM portfolio, and into late October 2011, S&P continued to believe that MF Global's underlying credit fundamentals supported a credit rating of 'BBB-'.

S&P's October 26, 2011 CreditWatch Action

In October 2011, concerns over escalation of the Eurozone credit crisis, combined with a disappointing earnings report from MF Global and other factors, were causing the firm's investors, counterparties and other market participants to become quickly and increasingly concerned about the firm.

Against this backdrop, S&P analysts participated in a meeting with MF Global management on October 20, 2011, in order to obtain additional information about the firm's upcoming earnings release, its strategic plan and more detail regarding the RTM portfolio. At this time, the European sovereign investments contained in the off-balance sheet RTM portfolio continued to be investment grade rated and had short maturities and locked-in funding through the date of maturity.[3] During the October 20 meeting, MF Global executives stated that the firm believed its financial condition was strong. Four days later, on October 24, 2011, MF Global's CFO sent a follow-up e-mail to S&P's analysts stating, among other things, that he believed MF Global's "capital and liquidity has never been stronger" and that "MF Global is in its strongest position ever as [a] public entity."

On that same day, October 24, Moody's Investors Services downgraded its credit rating of MF Global to a level that corresponded to S&P's 'BBB-' rating, which had been in place since November 2010. The following day, notwithstanding management's optimism, MF Global reported a net GAAP loss of $191.6 million for the previous quarter, largely as the result of a non-cash write-down in the value of its deferred tax assets. During the investor call announcing this disappointing result, the firm's CEO, Mr. Corzine, stated that MF Global's RTM positions continued to have "relatively little underlying principal risk in the timeframe of our exposure" and that "the structure of the transactions themselves essentially eliminates market and financing

3 We note that as of the date of this submission, none of the sovereign entities contained in the off-balance sheet RTM portfolio have defaulted.

risk." Nevertheless, MF Global's stock price fell by nearly 50 percent the day of this earnings announcement, reflecting a potential crisis in confidence among investors and others.

On October 26, 2011, a committee of S&P analysts voted to place the 'BBB-' credit rating of MF Global on CreditWatch with negative implications and S&P issued a report to that effect. This action reflected S&P's view that, among other things, continued volatility in the capital markets and low interest rates could further harm MF Global's ability to generate capital. The report also discussed MF Global's RTM exposure and the firm's increased risk profile. The October 26 report concluded by stating that S&P could soon lower MF Global's rating to a speculative, non-investment grade level depending on the firm's execution of strategic plans (which included a potential short term sale of certain operations), balance sheet management, and plans for its future proprietary trading activity. Over the next several days, S&P's analysts did in fact actively consider a further downgrade based in part on MF Global's inability to execute a strategic sale.

S&P's October 31, 2011 downgrade to 'D'

On October 31, 2011, MF Global filed for bankruptcy protection. As a result, S&P downgraded the firm's credit rating to 'D'. In S&P's view, MF Global's collapse was not caused directly by its exposure to the RTM portfolio -- a fully-funded investment in sovereign debt scheduled to mature by December 2012. Rather, we believe MF Global's demise was driven primarily by a rapid, downward spiraling of confidence among market participants and counterparties who questioned the firm's transparency and its ability to attract and maintain investors and generate revenue.[4]

Conclusion

I thank you for the opportunity to participate in this hearing and I would be happy to answer any questions you may have.

4 S&P does not purport to audit the issuers it rates and does not undertake to police issuers for fraudulent activity or misconduct. Nevertheless, S&P does evaluate the quality of information it receives and also requires issuers to provide accurate information as a condition to receiving a rating. In this case, MF Global was required to warrant that all information it provided to S&P regarding its rating contained "no untrue statement of material fact" and did not omit material facts so as to render the information misleading. When S&P does not believe that it has sufficient high-quality information, it will refuse to provide ratings, or withdraw ratings, as appropriate.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	**2. Organization or organizations you are representing:**
Craig A. Parmelee	Standard & Poor's
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☑ No	☐ Yes ☑ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature: C. A. P	

Please attach a copy of this form to your written testimony.