Testimony Concerning:
"Oversight of the Credit Rating Agencies Post Dodd-Frank"

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On behalf of Rapid Ratings' employees and shareholders, I would like to thank Chairman Neugebauer, Ranking Member Capuano and members of the Subcommittee for asking me to submit testimony for the hearing titled *Oversight of the Credit Rating Agencies Post Dodd-Frank* before the United States House of Representatives' Committee on Financial Services, Subcommittee on Oversight and Investigations.

As we arrive at the one year anniversary of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) we continue to face essentially the same ratings landscape as one year ago. The Big Three ratings firms, S&P, Moody's and Fitch, have had banner years given record bond issuance for most of the year and their influence is undiminished, competitor NRSROs have even more challenges than ever before, and non-NRSRO rating agencies, like Rapid Ratings, watch the disincentives to an NRSRO application mount ever higher.

Dodd-Frank and the Securities and Exchange Commission's (SEC) implementing regulations, which are currently out for comment, are a combination of positive, negative and worrisome initiatives. Dodd-Frank does not do much to truly foster competition in the market, and depending on how the SEC decides to implement its new oversight responsibilities, may even directly hinder it. Moreover, we know Dodd-Frank adds significantly to costs for smaller NRSROs in terms of legal, administrative and compliance expenses, board compensation, insurance costs, and more.

Dodd-Frank has some positive elements for effective change in this industry, but it also gets bogged down in window dressing that ultimately does little except apply a disproportionate burden on the small NRSROs while providing little more than an administrative hassle to the Big Three. Dodd-Frank is right to reduce references to NRSROs in federal regulations. But, it is drifting down a slippery slope in increasing liability standards for CRAs. In an effort to determine accuracy in ratings and oversight of methodology, Dodd-Frank risks actually homogenizing ratings, increasing systemic risk and putting competitors' intellectual property at risk. In the following pages we detail many of the sections within Dodd-Frank and highlight what we consider good, bad and neutral in the new rules.

There is no silver bullet to change this industry. Use of NRSROs is too embedded in workflow practices of the investment community and in not just federal regulations but is prevalent in state regulations, private contracts, bank pricing grids, pension parameters, internal risk guidelines of institutional investors and on and on. But change can happen with effort. Like whale oil to petroleum, horses to cars, typewriters to computers and mail to email, innovation comes to markets that are not artificially protected and supported. New ideas, methodologies, ambitious teams of people, capital, hard work, and time, will ultimately prevail. It is incumbent upon legislators and regulators to help, not unintentionally hinder, this evolution.

Background

Rapid Ratings is a subscriber-paid firm. We utilize a proprietary, software-based system to rate the financial health of thousands of public and private companies and financial institutions quarterly. We use only financial statements, no market inputs, no analysts, and have no contact in the rating process with issuers, bankers or advisors. Our ratings have an impressive record for far outperforming the traditional issuer-paid rating agencies in innumerable cases and also generally outperforming the prevalent market-based default probability models.

We rate companies irrespective of whether they are bond issuers. We also do not distinguish between those companies that are issuing new securities versus those who have securities outstanding. Unlike the Big Three, we are focused on providing ratings that are updated quarterly and provide the highest accuracy, breadth of coverage and speed to market to reflect the changing financial health profile of firms we rate. The Big Three are naturally focused on primary issuance, where they traditionally get paid the majority of their fees, and risk surveillance of ratings already issued is a secondary focus. This is one of the great failings of the incumbent system and a perfect example of where a new player employing an innovative methodology can provide great value relative to the status quo.

Much has been made of the ratings industry problems: conflicts of interest, inaccurate ratings, lack of proper oversight, unchecked growth, fight for market share, overreliance on NRSRO ratings, lack of competition in the market to challenge the "Big Three" (S&P, Moody's and Fitch), and the list goes on.

Dodd-Frank is supposed to curb conflicts of interest, reduce the risks inherent in the current ratings industry market structure, add transparency, force compliance, instill accountability, promote ratings accuracy, lower investor reliance, evolve the structured products ratings process and foster competition in the ratings industry.

US legislative and regulatory attention to the ratings industry is concentrated on the NRSRO designation and therefore the 10 players that currently carry that status. Since my business partners and I acquired Rapid Ratings and moved the business from Australia to the US in 2007, we've taken the view that having an NRSRO registration was undesirable given the dramatically changing environment for NRSROs. Little has changed my view over the past few years of SEC and Congressional activity. Why take a young, hungry competitor in the ratings space and subject it to all manner of change, increased scrutiny, costs, liabilities, uncertainties and a playing field that changes, then changes again, and so on?

My background, prior to the acquisition, was not in the ratings business. I was a debt capital markets officer for large banks, a technology entrepreneur and a boutique investment banker for small to mid-sized enterprises. I had extensive interactions with the rating agencies, particularly the big three NRSROs. I saw ratings shopping, I worked with bankers who had just arrived fresh from jobs at the Big Three agencies and were hired to advise bank clients on how to get the best ratings from their ex-colleagues, and in general the agencies were a central feature of any bond issue – structured bond or plain vanilla corporate issuance.

As a ratings entrepreneur however, I would like to think I did, and do, view the ratings business from a fresh perspective. The opportunities for a sophisticated and innovative competitor firm are significant; however, so are the obstacles. No business I have ever run, worked in or advised, has ever operated in such an idiosyncratic market -- historical regulatory support for incumbent players, a true oligopoly, massive criticism every few years followed by superficial *mea culpas*, well-meaning but often less than effective reforms, and tremendous lobbying by the incumbent players.

It is important to recognize that there are many market players who benefit from, and support, the status quo. After all, it is easy to rely on S&P and Moody's. It is cheaper to rely on S&P and Moody's than to staff an independent credit department. It is simpler to use the government sponsored imprimatur than to decide on what alternatives to use. It is advantageous for funds that are not allowed to buy below investment grade bonds to buy the highest yielding, lowest investment grade bonds because there is a regulatory arbitrage to do so.

Rapid Ratings' Evaluation of the NRSRO Opportunity

In prior testimonies such as to the Securities & Exchange Commission's "*Roundtable to Examine Oversight of Credit Rating Agencies*," to the U.S. Senate Committee on Banking, Housing, and Urban Affairs at a hearing titled *"Examining Proposals to Enhance the Regulation of Credit Rating Agencies,"* to the United States House of Representatives' Committee on Financial Services' Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises at a hearing titled "*Transforming Credit Rating Agencies,*" and to the International Organization of Securities Commissioners ("IOSCO") Standing Committee Six, Rapid Ratings has been clear that getting the NRSRO designation at present would be more a contingent liability than an asset.

Given this position, we observe all of the changes that come from Dodd-Frank from three perspectives: 1) What if we were an NRSRO now? 2) Do we want to consider applying to become an NRSRO now? and 3) What effects will Dodd-Frank have on us as a non-NRSRO if we remain as such?

While the answers are complex, they can be summarized:

1) If we were an NRSRO now we'd be subject to massive increases in our operating costs and significantly more complex internal processes. We'd be taking on increased liability. We'd be at the mercy of the SEC and its eventual rules for disclosure of methodology and procedures, ratings accuracy, and other transparency--oriented initiatives.

2) As far as we can tell, the ultimate landscape for operating as an NRSRO is still very much up in the air. We consider many of the SEC's proposed methods of discharging their responsibilities under Dodd-Frank to be threatening our critical Intellectual Property and revenue model. The uncertainty on these issues alone is a massive disincentive to file an NRSRO application.

3) Until the SEC finalizes its rules and policies for carrying out Dodd-Frank, we cannot really answer this question for ourselves. The increased liability notwithstanding, we can continue to do our business and grow successfully, but have no further incentive to pursue the NRSRO status than we have had in the past.

In order to understand the ratings market and to reform the industry, it is critical to appreciate the complexities that abound and how deeply ingrained the use of traditional ratings has become. To those less familiar with the industry, it seems like one that can be altered through seemingly simple solutions – change the payment structure to disallow issuers to pay for their ratings and force transparency on the raters. But the use of the Big Three's ratings goes much deeper than it appears, and the roots of their influence run wider than most understand.

Dodd-Frank and Reform in the Ratings Industry

Increasing reporting, increasing liability and even removing references to NRSROs are all elements, but not solutions unto themselves. More regulation and reporting requirements, and even increased liability, have the opposite of the intended effect; they help the incumbents as much as they hinder them.

Reform will ultimately only come when the following facets of change are promoted effectively:

- Increase the landscape for competition. Do not allow unintended barriers and compliance costs to stifle smaller players and newer revenue models;
- As mandated by Dodd-Frank, remove references to NRSROs from regulations in an effort to, over time, decrease dependence and irresponsible, risky reliance on the Big Three firms;
- Promote innovation in ratings and market stakeholders' use of myriad risk management inputs. Do not allow a homogenization of ratings;
- Increase the flow of data critical to providing new ratings into the market;
- Recognize that the status quo is supported on all fronts by some, though not all, players. This includes ratings firms, sell-side shops, regulatory and legislative infrastructure and members of the investment community;

- In the following sections, we've outlined Dodd-Frank developments that we believe are positive, negative and neutral at present. We also highlight a few areas uncovered by Dodd-Frank. Finally, we also include a suggestion for a simple, yet powerful addition to the SEC's oversight in the ratings industry:
    - **Positive Developments**
        - Removal of statutory references to ratings
        - Accountability and transparency of NRSROs —Look-back requirement
    - **Negative Developments**
        - Accountability and transparency of NRSROs —Methodologies reviewed
        - Accountability and transparency of NRSROs —Ratings performance
            - *Why are accurate ratings good?*
            - *What are the economic effects of the stability vs. accuracy debate?*
            - *Absolute vs. Relative Risk*
            - *How can ratings accuracy be bad?*
            - *Disclosure of ratings histories*
        - Accountability and transparency of NRSROs —Board composition
        - Eliminating the three-year requirement in NRSRO accreditation
        - Liability issues
    - **Neutral Developments**
        - Qualifications standards for NRSRO analysts
        - Separation of sales/marketing and ratings analysts
    - **Other Factors**
        - Access to data required for unsolicited ratings
        - Corporate counterparty risk
        - The Franken Amendment
        - Rapid Ratings Proposal for Increased Ratings Accuracy and Integrity

Positive Developments

SEC. 939. REMOVAL OF STATUTORY REFERENCES TO CREDIT RATINGS[1]

We believe that the removal of statutory (laws) and regulatory (administrative requirements) references is one of the key tenets to ultimate change in the ratings industry. References in federal statutes have been a major contributor to the market's reliance on the dominant NRSROs for decades. Combined with statutory and regulatory references, investment

[1] United States. Cong. House of Representatives. *Dodd-Frank Wall Street Reform and Consumer Protection Act.* 111th Cong., 2nd sess. H.R. 4173. Washington: GPO, 2010. Web. (508) http://www.gpo.gov/fdsys/pkg/BILLS-111hr4173enr/pdf/BILLS-111hr4173enr.pdf

managers have constructed policies to comply with the NRSRO standards, international standards such as Basel I, Basel II and Basel III international banking regulations have followed suit and thus the market has been able to rely on the constant presence of NRSRO ratings in myriad ways. In many respects, nothing has contributed as much to the market overreliance on NRSROs as these references and the explicit mandate that they be used.

We accept that removing references is easier than finding their replacements. Various federal agencies have been instructed by Dodd-Frank to make changes such as striking "'nationally recognized statistical rating organization' and inserting 'meets such standards of credit-worthiness as the Commission [Securities and Exchange Commission] shall adopt.[2]'" Nevertheless, a pure "replacement" may be impossible to find and we challenge the view that any single replacement would be appropriate given that the original option (NRSRO ratings) did not pan out particularly well as a standalone risk measurement

As an example, Credit Default Swaps are often proposed as an appropriate proxy for risk. While CDS are likely the most sophisticated measure of the market-based options, they have significant limitations:

- **Narrow Range:** There are not CDS on enough issuers, thus giving only partial coverage of the investible universe, and there are few CDS on private companies;
- **Liquidity:** Some credit default swaps are traded in much larger volume and with much greater frequency than others;
- **Volatility:** CDS, as with all market measures, have inherent volatility. This means a regulatory framework where capital is benchmarked to CDS will fluctuate, potentially significantly. As with all market measures, CDS are subject to technical factors that have nothing to do with the credits themselves but will have to do with overall market liquidity, volatility, short-selling, etc. The swings that can occur due to these factors, particularly if they are market-wide, can skew the risk profile of a portfolio that will improve or deteriorate in a correlated fashion instead of on a credit by credit basis. Good credits will be unnecessarily penalized while poor credits may well be obscured or buffeted inappropriately.

  As cases in point, if risk was benchmarked to CDS, GE/GECC would have been rated CCC in March of 2009 and Italy, Spain and various global commercial banks would have been downgraded to junk in the weeks leading up to this hearing.

Rapid Ratings firmly believes that market-wide risk management should not be prescriptive but that players needing to manage risk must be encouraged to take diverse approaches. There is no single measure of risk that is appropriate for all market players at all times. Multiple factors

[2] (H.R. 4173, 511)

need to be taken into account and federal agencies need to be creative in replacing the NRSRO references. Most importantly, agencies need to avoid being reductionist and looking for an answer that is too simple.

Irrespective of the above and of the ultimate conclusion of each federal agency, removing NRSRO references is an essential place to start and is fundamental to sending the clear message to the market that dependence on traditional ratings is no longer acceptable, reliable or responsible. Investors must look for alternatives and many must deepen their own work.

SEC. 932. ENHANCED REGULATION, ACCOUNTABILITY, AND TRANSPARENCY OF NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS
(4) LOOK-BACK REQUIREMENT

This "look-back" provision is a positive development although it is unlikely to have a major effect. For decades banks have been hiring from the rating agencies into "rating agency advisory" groups dedicated to guiding issuers (bank clients) in how to get the best rating from the agencies. Essentially it has been the most institutionalized form of "ratings shopping" and non-trading "ratings arbitrage" in the market. Forcing disclosure of such employment transitions will put a spotlight on this practice and possibly deter some potentially conflicted hirings from taking place. This is peripheral in the broad scheme of ratings reform however.

The more direct practice of hiring an NRSRO employee is also addressed: "person subject to a credit rating of the nationally recognized statistical rating organization or the issuer, underwriter, or sponsor of a security or money market instrument subject to a credit rating of the nationally recognized statistical rating organization."[3] If the employee participated in the ratings process and gets hired by the issuer or banker, this new provision will certainly bring to light, if investigated, any blatant acts of bribery or rewarding of rating agency employees who move from the agency. We doubt there are actually many instances of this happening, but the Dodd-Frank provisions can provide some comfort that there will be a responsibility among NRSROs to bring the possible instances to light.

<u>Negative Developments</u>

SEC. 932. ENHANCED REGULATION, ACCOUNTABILITY, AND TRANSPARENCY OF NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS
(s) TRANSPARENCY OF CREDIT RATING METHODOLOGIES AND INFORMATION REVIEWED

We view the information prescribed for disclosure to be troubling. While we appreciate the intended outcome is to increase disclosure and transparency into ratings, we believe there is potential for a far greater negative effect. The information required as per the Dodd-Frank language will jeopardize the private nature of some ratings intellectual property. Given the

[3] (H.R. 4173, 508)

choice to be an NRSRO and have private property rights at risk and remaining a non-NRSRO, our route is clear. Moreover, we are certain that others who will one day bring innovation to the ratings space will think similarly.

Specifically, the language required in (1) FORM FOR DISCLOSURES, (A) information relating to – "(i) the assumptions underlying the credit rating procedures and methodologies"[4] has, depending on interpretation by the SEC, threatening ramifications. If assumptions underlying methodologies are at one level of depth, that is benign. If it is at a deeper level, it could be probing information that is proprietary and commercially sensitive.

Then in the following two subsections listing qualitative and quantitative disclosure criteria, there are many items which in isolation may or may not be acceptable, but in aggregate present a tremendous threat to intellectual property protection of a ratings firm:

''(3) CONTENT OF FORM.—
''(A) QUALITATIVE CONTENT.—Each nationally recognized statistical rating organization shall disclose on the form developed under paragraph (1)—
''(ii) the main assumptions and principles used in constructing procedures and methodologies, including qualitative methodologies and quantitative inputs and assumptions about the correlation of defaults across underlying assets used in rating structured products;
''(iii) the potential limitations of the credit ratings, and the types of risks excluded from the credit ratings that the nationally recognized statistical rating organization does not comment on, including liquidity, market, and other risks;
''(ix) such additional information as the Commission may require.

''(B) QUANTITATIVE CONTENT.—Each nationally recognized statistical rating organization shall disclose on the form developed under this subsection—
''(i) an explanation or measure of the potential volatility of the credit rating, including—
''(I) any factors that might lead to a change in the credit ratings; and
''(II) the magnitude of the change that a user can expect under different market conditions;
''(ii) information on the content of the rating, including—
''(I) the historical performance of the rating; and
''(iii) information on the sensitivity of the rating to assumptions made by the nationally recognized statistical rating organization, including—
''(I) 5 assumptions made in the ratings process that, without accounting for any other factor,

4 (H.R. 4173, 504)

would have the greatest impact on a rating if
the assumptions were proven false or inaccurate;
and
‘‘(II) an analysis, using specific examples, of
how each of the 5 assumptions identified under
subclause (I) impacts a rating;
‘‘(iv) such additional information as may be
required by the Commission.[5]

It does appear as though the SEC is interpreting these requirements to pertain only to structured product ratings and as such may not directly apply to Rapid Ratings unless we move into this asset class. However, for other quantitatively oriented firms that want to get into this ratings class, these data requirements are unprecedented and, in the extreme, would allow the reverse engineering of our methodologies. Again, as things stand, the cost benefit calculus of becoming an NRSRO and subjecting ourselves to this disclosure is clear – remain a non-NRSRO.

SEC. 932. ENHANCED REGULATION, ACCOUNTABILITY, AND TRANSPARENCY OF NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS

(q) TRANSPARENCY OF RATINGS PERFORMANCE

Accuracy of ratings is a key element of Dodd-Frank Subtitle C. It appears as a justification for the Establishment of Office of Credit Ratings at the SEC, in instructions to the SEC on enforcement of Dodd-Frank provisions, in transparency of ratings performance and in a number of other instances.

There is a subtle but critical distinction that needs to be recognized when discussing accuracy: more accurate ratings are good for the market. Regulatory enforcement of a prescription of accurate ratings is bad for the market. It is not regulations and rules that produce accuracy; it is innovation and competition in the marketplace.

Why are accurate ratings good?

As stated in the preamble to Subtitle C “In the recent financial crisis, the ratings on structured financial products have proven to be inaccurate. This inaccuracy contributed significantly to the mismanagement of risks by financial institutions and investors, which in turn adversely impacted the health of the economy in the United States and around the world. Such inaccuracy necessitates increased accountability on the part of credit rating agencies.” The accuracy of Big Three ratings has long been the subject of debate. That debate is strategically important because it makes the incontrovertible argument that accuracy is more important than the “stability” of ratings. The traditional issuer-paid firms have used “rating stability” as a shield to deflect attention from the challenge and charge of “inaccurate ratings.”

[5] (H.R. 4173, 505-506)

The Big Three produce ratings that they refer to as "rating through the cycle" as a means of providing "stable" ratings. The concept of rating through the cycle is to have ratings that reflect the longer-term perspective of an issuer at the conclusion of its cycle, rather than reflecting the intra-cycle condition of the company. The result, of course, is ratings that exhibit little or no change because the agency is not continually reflecting any ups and downs the issuer may experience over time. Only when the agency considers a truly material change to warrant a rerating will there be a change. The precipitous drops of homebuilders long after the market knew of the housing crises, Enron's remaining investment grade until hours before it filed for bankruptcy and countless other examples expose the weakness of this methodology.

The Big Three typically defend this position by citing studies that the investment community wants to have ratings stability. While there are studies that document the opposite position, in fairness, many institutional investors do want to avoid volatility in rated portfolios given the inconvenience of frequent portfolio rebalancing. Further, some regulators have supported the view that monitoring firms' capital adequacy frequently is too burdensome on the firms and the regulators. Unfortunately, rating through the cycle means being less sensitive to the short and medium term changes in a credit that make it more or less healthy at any given time. Being rated too low incorrectly has primarily opportunity cost implications. Being rated too high incorrectly can have material real dollar cost implications. Having widespread risk benchmarking correlated to these insensitive measures has real systemic risk cost.

A recently released working paper, *"Does the Bond Market Want Informative Credit Ratings?"* by Cornaggia and Cornaggia[6] tackles the question as to whether market participants benefit more from relatively stable ratings utilizing traditional methodologies than from quantitatively derived ratings that are timely and accurate. Moody's Credit Ratings (MCRs) are employed as a proxy for the Big Three. Cornaggia and Cornaggia categorize the MCRs as compensated by issuers and based on qualitative analysis geared toward stability in rating levels that reflect only relative risk.

In order to test and benchmark MCRs, they select a system that provides contrast on multiple criteria. Cornaggia and Cornaggia write, "The Financial Health Rating (FHR) produced by Rapid

6 Cornaggia J, Cornaggia, K. Does the Bond Market Want Informative Ratings? http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1705843&download=yes. Jess Cornaggia, PhD, is an Assistant professor at Indiana University Bloomington - Kelley School of Business. Kimberly Rodgers Cornaggia, PhD, is an Associate Professor American University - Kogod School of Business. **The authors note**: "To support our use of Rapid Ratings as an exemplar, we note its recognition by regulators, law makers, and market participants. RR was the only non-Big-3 credit rating agency invited to speak on the ratings competition panel at the SEC Roundtable in 2009 and to testify before both congressional bodies in the run up to the most sweeping change in rating agency regulation in history."

Ratings (RR) is compensated by subscribers, based on quantitative models, and geared toward the timely release of information as it pertains to absolute credit risk." [7]

In the body of the working paper, MCRs are tested rigorously for information content against FHRs. The authors write, "We document that among bonds that ultimately default, RR downgrades the FHR to speculative grade status long before the Moody's credit rating follows suit." The data tests speak to the magnitude of these findings demonstrating that Rapid Ratings is 2.9 years earlier than Moody's.

One test in the study compared default frequencies among issues with investment grade ratings. The professors report a higher default frequency among issues with investment grade ratings according to the MCR compared to the FHR, writing "2.61% of defaulting firms had FHRs classified as investment grade one year prior to default." The corresponding number of defaulting firms with investment grade MCRs is 5.67%.

Cornaggia and Cornaggia contextualize these findings with respect to Moody's' stated position that stable ratings help avoid market disruptions. They postulate that gradual ratings downgrades may have disrupted the financial markets less than the huge volatility spikes and losses of investor confidence that accompanied the too-late downgrades of Enron and AIG among others. This bolsters the position of those who have claimed that over-reliance on traditional credit agency ratings increase vulnerability to sudden market shocks.

What are the economic effects of the stability vs accuracy debate?

Wealth effects are also quantified in this study by calculating the differences that would have been realized by trading on the early versus late downgrade. A portfolio manager selling bonds on FHR downgrade would significantly mitigate losses relative to selling at the MCR downgrade. In the study's own words, "The results indicate significant differences in the prices and yields at the various points in time. Prices are significantly lower ($11.70 to $15.40) and yields are significantly higher (5.9% to 9.7%) when Moody's downgrades the bonds to speculative grade than when RR downgrades the bonds' issuers. These results highlight the costly consequences of delaying sales beyond the earlier FHR warning." The authors point out that this result is significant given evidence of "fire sales associated with regulatory compliance."

[7] Gellert, James H. The United States of America. *Competition in the Credit Rating Industry: Are we asking the right questions and getting the right answers?*. Washington: , 2009. Web. 25 Jul 2011. http://www.sec.gov/comments/4-579/4579-20.pdf

Absolute vs Relative Risk

Much is made of the ratings scales that dominate the ratings industry. Symbology and commonality of the scales are referred to often in Dodd-Frank.[8] However, the traditional alpha scale is both ordinal and less informative than the Rapid Ratings' cardinal scale. For instance, ask anyone familiar with ratings what it means to be a "single A credit." Then ask them what it means to be a "BBB credit." Then ask what the difference is between those two. Then ask what it means to be a certain rating this year vs. next year vs last year. None of these questions will have satisfactory answers. The reason is that default associations with each traditional rating letter grade change yearly. And, while users know that an A is better than a BBB, which is better than a BB and so on (relative risk), the distance between them, the magnitude of that distance and the importance relative to health or failure among them is unknown (absolute risk) using the traditional ratings systems.

To highlight this problem, Cornaggia and Cornaggia site as examples the following: "4.1% of bonds rated A3 (investment grade) defaulted in 2003 yet no bonds rated B2 (speculative grade) defaulted in 2007. As another example, 30.6% of bonds rated A1 defaulted in 2008" (extreme example influenced by the Lehman Brothers failure).

The professors add, "We confirm that the FHR better reflects absolute credit risk than the MCR. Default frequency within investment and speculative grade classifications, as indicated by the MCR, varies significantly from year to year. However, default frequency within investment and speculative grade classifications, as indicated by the FHR, exhibits less variation. The distinction between absolute and relative credit ratings has potential implications for efficient capital allocation."[9]

How can ratings accuracy be bad?

Dodd-Frank and the SEC seek to determine what are accurate ratings and what are not, as a means of providing transparency in, and disclosure from, the ratings industry. There is a natural desire to provide insight into how agencies score in getting ratings right, and getting them wrong. In concept this is reasonable except for three important concepts: 1) not all ratings are created to measure the same things; 2) how does one, the SEC or otherwise, determine what is "accurate;" and 3) what happens when all agencies begin producing ratings knowing they will be measured by a specific definition of accuracy?

1. Traditional agencies solve for slightly different definitions of ratings. S&P claims to rate the ability and willingness of an issuer to meet its financial obligations in full and on time. Moody's claims to rate an issuer's likelihood of default and any financial loss

[8] (H.R.: 4173, 510)
[9] (Cornaggia and Cornaggia, 5)

suffered in the event of default. Rapid Ratings provides a firm's Financial Health Rating (FHR), a measure of how efficiently a company is run and how well positioned it is to maintain its competitive position against its global, industry-specific peer group. This measure is highly correlated to defaults (low FHRs to high default histories,) but in fact is not a default measurement. As time goes on, we anticipate other methodologies and ratings standards to also emerge if the market is attractive to new entrants.

2. Rating accuracy is difficult to measure and the SEC has proposed a wide variety of elements for comment covering ratings transitions, default associations, etc. How the SEC will determine what constitutes accuracy is anyone's guess at this stage.

3. In many respects, what is more challenging to imagine than how the SEC will define ratings accuracy, is what happens if they do? In our view the fastest way to positively evolve the ratings industry is for more ratings opinions and innovative ways of measuring risk to be available to the marketplace. If ratings "accuracy" is prescribed by regulation, over time, agencies will naturally engineer ratings to the standard by which they are being measured. Those that become "most accurate" will be those that are least differentiated and most highly correlated. This means fewer diversified opinions, not more. In the end, it should be what the market accepts as the new standard for determining accuracy, rather than regulatory guidance that determines what is accurate and what is not given different investments and conditions. Our concern is based on our knowing that in the ratings industry regulations can have decades-long negative effects.

   In the extreme, if most agencies wish to be viewed as "accurate" and benefit from all that a high accuracy score may provide, the regulatory framework will counter-productively be promoting a homogenization of ratings, not an improvement in the ratings industry.

   If these guidance-based ratings are broadly used in the market, this prescriptive ratings paradigm will increase the systemic risk embedded in the market, not reduce it. Correlating the risk management measures of wide swaths of ratings users could be one of the most short -sighted outcomes conceivable from the entire Dodd-Frank era.

Disclosure of ratings histories

Rule 17g-2[10] requires an NRSRO to provide ratings histories to the public for free in order to allow their ratings to be judged by market players. This topic has been troubling for Rapid Ratings and for others for a number of years. As we assess NRSRO status, the requirement to publish our ratings for free to the market has always been entirely cannibalistic for our revenue model – to get paid by subscribers for our ratings. Nevertheless, when the SEC created the one year embargo for issuer-paid firms and a two year embargo for subscriber-paid firms we thought this was at least more palatable.

Having this distinction between issuer-paid firms and subscriber-paid was a significant development in SEC ratings oversight two years ago. It provided some confidence that the SEC appreciated the distinction between the revenue models and was not trying to paint reform with a wide brush. However, the recent proposed rules by the SEC request comment on the appropriateness of the 1 year and 2 year grace periods. It is disconcerting that the embargo time frames are out for comment again, suggesting the SEC may reconsider their original decision on this topic.

SEC. 932. ENHANCED REGULATION, ACCOUNTABILITY, AND TRANSPARENCY OF NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS

'(t) CORPORATE GOVERNANCE, ORGANIZATION, AND MANAGEMENT OF CONFLICTS OF INTEREST

Another perplexing provision of the accountability rules concern Board of Directors composition and governance. As stated:

''(1) BOARD OF DIRECTORS.—Each nationally recognized statistical rating organization shall have a board of directors.
''(2) INDEPENDENT DIRECTORS.—
''(A) IN GENERAL.—At least ½ of the board of directors, but not fewer than 2 of the members thereof, shall be independent of the nationally recognized statistical rating agency. A portion of the independent directors shall include users of ratings from a nationally recognized statistical rating organization."[11]

[10] *PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934*. Washington: Web. 25 Jul 2011. http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=47b43cbb88844faad586861c05c81595&rgn=div5&view=text&node=17:3.0.1.1.1&idno=17#17:3.0.1.1.1.2.96.408 (Rule 17g-2)
[11] (H.R.: 4173, 507)

There are costs, hidden costs and new conflicts of interest embedded in these rules:

- *"a portion" of directors "shall include users of ratings" from a NRSRO.* This is problematic because the firm will be required to share inside information with an institutional investor

- These outside board members will be terribly conflicted if they indeed work at an institutional investor. The level of detail they would have about capital markets trends, specific information on market players and issues would be stunning and unprecedented for a member of the buy-side of Wall Street. Alternatively, a sell-side professional would be just as conflicted under these circumstances.

- As per section 932 of Dodd-Frank, the board has authority over the ratings methodology. Once again, this means the institutional investors on the board would have access to potentially conflicted data and process information.

- With the increased liability provisions of Dodd-Frank in particular, the role of an NRSRO board member is not that attractive. Given the increased liability, finding someone to take this role could be a challenge and will certainly be costly in terms of compensation

- Directors and Officers insurance is also a significant cost and going higher for NRSROs. One can only imagine the cost, if it is obtainable at all, for a firm when the carriers understand the potential conflicts of interest inherent in having institutional investors on the boards of rating agencies

Dodd-Frank allows for a small company exception for these board rules. However, there is little insight into who qualifies and how a firm adjusts once that exemption becomes disallowed due to growth in size.

SEC. 932. ENHANCED REGULATION, ACCOUNTABILITY, AND TRANSPARENCY OF NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS

CONFORMING AMENDMENT SEEMINGLY ELIMINATING THE "THREE YEAR" REQUIREMENT FOR NRSRO APPLICATION[12]

There is an obscure Conforming Amendment that seems to modify an important component of the Credit Rating Agency Reform Act of 2006[13] (CRA Act) requiring new NRSRO applicants to have been rating in an asset class for three years prior to submitting an application. We were encouraged at the initiative to roll back this particularly poor element of the CRA Act. Nevertheless, we understand now that this was an erroneous reference and is being corrected. The result is that indeed the three year requirement stands.

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12 (H.R. 4173, 508)

13 United States. Cong. Senate. *Credit Rating Agency Reform Act of 2006.* 109th Cong. 2nd Sess. S. 3850. Washington: GPO, 2006. Web. http://www.gpo.gov/fdsys/pkg/BILLS-109s3850pcs/pdf/BILLS-109s3850pcs.pdf

This was going to be a positive development for industry competition. Many observers were perplexed when the CRA Act included this provision, and it was perceived to be a last minute addition to the drafting of the Act possibly to satisfy a lobbying demand. In essence, the restriction has been a massive barrier to entry to competitors, almost guaranteeing the Big Three were able to maintain their oligopoly in structured products ratings leading up and into the Subprime Crisis. Only one viable new structured product player and NRSRO applicant emerged in the years immediately following the Act and they covered commercial mortgage backed CDOs, and not residential.

From a competitive standpoint, if a ratings firm wishes to become an NRSRO, we believe they should be able to apply and be granted the designation if they are deemed to qualify by the SEC. Practically speaking, having a three year hurdle was likely a disincentive to new players entering over the past few years. Removing this would be a very positive step and having it survive as a key criterion for NRSRO application means there continues to be a significant barrier to entry for new competitors. For asset classes like structured products and municipal ratings, where there are few non-NRSRO players that can demonstrate a three year track record, the closed nature of the club remains.

SEC. 933. STATE OF MIND IN PRIVATE ACTIONS- LIABILITY ISSUES

The increased liability provision of Dodd-Frank facilitates actions against any Credit Rating Agency if they "knowingly or recklessly failed"

''(i) to conduct a reasonable investigation of the rated security with respect to the factual elements relied upon by its own methodology for evaluating credit risk; or

''(ii) to obtain reasonable verification of such factual elements (which verification may be based on a sampling technique that does not amount to an audit) from other sources that the credit rating agency considered to be competent and that were independent of the issuer and underwriter.''[14]

Liability dominated the reform debate throughout 2009 and into the enacting of Dodd-Frank. It is perhaps the most political charged and roundly understood concept for reform by the public at large. It may indeed be fair to levy stricter liability standards on those agencies that made such egregious errors contributing to the crisis. But, facilitating private actions against all CRAs, regardless of whether or not they are NRSROs is a significant barrier to entry not just to the NRSRO club but to companies' getting into ratings in the first place.

[14] (H.R.: 4173-509)

As a quantitative business and one that has no contact whatsoever with issuers in the ratings process, Rapid Ratings is affected somewhat differently than a highly qualitative business and one that focuses on due diligence and issuer contact as their cornerstone. Nevertheless, all ratings firms are experiencing increased legal bills and higher insurance costs of all kinds. The threat of suits, whether meritorious or not, is a concern that all firms have to manage.

The issuer-paid firms have higher risks in this regard since subscriber-paid firms have bilateral subscription contracts with users of their ratings, but it is problematic for all.

A fascinating development as Dodd-Frank was being resolved was the subtle change in language in Sec 933 from NRSRO to "credit rating agency." This change was the only material instance where even non-NRSROs were captured by new statute. The definition of credit rating agency is rather broad and certainly open to interpretation. From the Credit Rating Agency Reform Act of 2006:

SEC. 3. DEFINITIONS.
"(a) SECURITIES EXCHANGE ACT OF 1934.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended by adding at the end the following new paragraphs:
''(60) CREDIT RATING.—The term 'credit rating' means an assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments.
''(61) CREDIT RATING AGENCY.—The term 'credit rating agency' means any person—
''(A) engaged in the business of issuing credit ratings…"[15]

Without question this definition, and therefore increased liability, is affecting many firms whether they saw themselves as potential NRSRO candidates at some point in the future or not. Nevertheless, any new player looking at entering the market needs to be very sensitive to this increased liability and to make sure they are properly capitalized for the legal costs at set-up and as an ongoing concern.

What it unclear is why this wording change from NRSRO to CRA occurred. The most logical explanation is that the drafters wanted to make sure the liability provision affected the current NRSROs even if the firms decided to unregister as NRSROs. This says to us that the drafters knew there was a chance that the rest of the Dodd-Frank reforms would be so unpalatable to current players that they might try to escape the grasp of the new framework. If true, this is a powerful statement of recognition of the punitive nature of these reforms. One option, if this punitive change remains, is to give a safe harbor to CRAs that have never been NRSROs.

[15] (S. 3850, 3)

Neutral Developments

SEC. 936. QUALIFICATION STANDARDS FOR CREDIT RATING ANALYSTS

Instituting standards of training and competence for NRSRO analysts seems like a perfectly reasonable concept. In response, the SEC has proposed Rule 17g-9(c)[16], which would require the NRSRO to implement standards of testing and experience requirements. Having better trained analysts is a good goal. However, having the NRSRO responsible for designing and implementing the training does little to challenge old ways of thinking with new ways of thinking. “Path dependence” is one of the causes of the financial crisis, so letting the old teach the new within the agencies seems to encourage a perpetuation of old-school thinking.

One of the elements of this new rule would be a requirement for the analysts to understand the measurement of accuracy of ratings. Please refer to page 11 in this submission for thoughts on ratings accuracy and the challenges of requiring this knowledge.

SEC. 932. ENHANCED REGULATION, ACCOUNTABILITY, AND TRANSPARENCY OF NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS
(3) SEPARATION OF RATINGS FROM SALES AND MARKETING

The concept of separating sales and marketing from ratings is fine, but too much is made of this as a major initiative; it is marginal, at best. Rule 17g-5, new paragraph (c)(8)[17] prohibits NRSRO employees from participating in both sales and marketing efforts of an NRSRO and also rating securities. This removes the most egregious potential conflict but it is naïve to think that ratings analysts are then somehow insulated from the knowledge that firm success is dependent on ratings business. Every employee at an issuer-paid NRSRO, whether involved with sales or not, knows that they do well if the business does well (whether compensation is directly tied to growth or whether growth simply provides job security) and the business does well if they rate more securities. This was at the heart of the clamor for structured product ratings market share and the degradation of ratings standards that accompanied that land-grab.

Dodd-Frank does provide for small firm exceptions, which is positive. But there is no definition for what is small, or when one might lose its “small’ status, or how much flexibility small firms might have. All of that, of course, creates compliance costs to understand and manage the constraints.

[16] (*PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934*., Rule 17g-9(c))

[17] (*PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934*., Rule 17g-5)

Other Factors

Access to information required for unsolicited ratings

In this entire area of structured product information disclosure, Dodd-Frank provides little improvement. In addition to all the new compliance rules and liability facing new entrants, those same new competitors are offered none of the additional disclosure or information that is required to evaluate, rate, and monitor structured finance vehicles such as CLOs. Prior SEC rules open up access to underlying data used for some structured product, but not for all. Basically, new competitors are offered new risks for little new opportunity. It is a material disincentive against entering the NRSRO and rating agency space.

For example, Collateralized Loan Obligation ("CLO") ratings

CLOs remain a viable asset class unlike many structured finance vehicles of the past several years. CLOs are important in the credit creation process and this helps the economy by allowing more credit to flow to companies beyond what is available from the banks and leveraged loan mutual funds. In CLO structures, the demand for higher risk loans is extended to high grade investors as a result of the higher rated tranching process. The CLO, like subprime RMBS, is another structured finance vehicle with universally high ratings from the rating agencies, and that can be a cause of concern over time depending on the quality of the assumptions and the underlying assets. The ratings process for such securities is stuck in the issuer-paid model and is a captive of the rating oligopoly the Fitzpatrick bill was supposed to help address. Dodd Frank has done nothing to correct some of the insurmountable barriers on the disclosure front.

The lack of disclosure on CLO structures combined with the tendency of originators to sell high risk loans into such structures does create significant risks of "excess" in hot markets that should be more closely monitored by investors. Investors need to do additional due diligence on such securities for their own safety and to reduce reliance on the rating agency oligopoly for models and assumptions.

As vehicles created by underwriters and managers of high risk debt instruments and placed with investment grade holders, the only detailed disclosure is in the hands of the large rating agencies (who award high ratings to the structures), the underwriters that sell the tranches, and the packagers and managers of such instruments. The underlying loan documentation and financial statements of the issuers whose loans have been sold into the structures often include private companies (LBOs etc.) where the high grade, high quality investor cannot gain access to the underlying documentation.

If investors and independent parties such as new rating agencies could gain access to the private companies' loan documents and financial statements packaged into CLOs and also get access to the CLO offering documents, meaningful competition could be brought into the ratings of CLOs. This is not just at new issue but also for purposes of ongoing risk surveillance. Distinct and similar disclosure improvement could also apply to other structured finance instruments. All of this information is readily available despite what lobbying groups will concoct. The idea that such disclosure will chill financings, proffered by some, is a Wall Street sales pitch and in fact a bluff since issuers get less expensive funding and more lenient structures through such vehicles. Dodd Frank does nothing to advance this disclosure and even crystallizes the obstacles by deterring competitors and leaving such disclosure concentrated in the hands of the major agencies. Unnatural barriers to entry in turn stack natural barriers to entry even higher.

The situation with CLOs, is made worse by the regulatory turf questions between the SEC and some of the bank regulators (Fed, OCC, FDIC). CLOs and disclosure rule for the underlying assets should be under the SEC, but the underlying assets (loans) are not securities and fall under the bank regulators (though there is no meaningful regulation of buying and selling bank loans). The fact that high risk assets are being repackaged and sold to high grade investors would seem to call for some more information so investors can defend themselves and rely less on the ratings issued by an oligopoly that gets fees for the high new issue ratings.

New rating agency competitors as well as investors in the CLOs cannot get access to the full range of underlying documents and asset level detail in such structures. Given that CLOs are high risk leveraged loans which are rolled up into investment grade structures in the AAA and AA range, such lack of disclosure leads to reliance on the rating agencies once again.

While these CLO structures did not create the magnitude of toxic problem we saw with subprime RMBS and commercial real estate in this past cycle, the overriding principal is still the same in that there is an *absolute* barrier to entry based on information availability that Dodd Frank fails to recognize or address. Investors end up relying on the agencies and cannot do the level of due diligence themselves given the closed information loop on such structures.[18]

Encouraging or mandating the SEC to revisit the breadth of the 17g-5 information access would be a positive direction. Getting the SEC purview over loans used as collateral for securities would be a significant leap forward. The two combined could lead to meaningful reform.

Corporate Counterparty Risk

When considering CLOs, and the companies that comprise their collateral, it is interesting to note that many international corporations use ratings for risk management purposes of their own. Ratings, from NRSROs, firms like Rapid Ratings as well as "credit bureaus," like Dun & Bradstreet (D&B) and Experian, provide ratings to corporations globally for assessing the risks

[18] "for a well prepared description of the CLO information conundrum, please refer to the April 10, 2009 submission to the SEC by CreditSights' CEO, Glenn Reynolds: http://www.sec.gov/comments/4-579/4579-19.pdf"

of customers (credit extension and accounts receivable management) and supply chain risk management. Interestingly, the credit bureaus are explicitly carved out of the CRA Act despite their providing a series of ratings for companies' risk management. The ratings also get used within financial institutions in vendor management (supply chain risk management) within large financial institutions, insurance companies, hedge funds and others. So, while the discussion about NRSROs is almost always focused on their capital markets' use, it is worth noting that their reach is much broader.

These corporations will often use NRSRO ratings and/or use the credit scoring of companies like D&B (by far the largest market share holder in this space) across their organizations for risk management purposes. Although corporations are much more forward thinking in using non-NRSRO and D&B type services than some institutional asset managers, there are still wide swaths of the corporate market that are correlating their risks on slow to change and rudimentary risk measures like S&P and Moody's ratings and payment-derived scores.

The "Restore Integrity to Credit Rating (Franken) Amendment"[19]

The Franken Amendment creates a government appointed board to distribute asset-backed security rating duties to NRSROs, hypothetically relieving NRSROs from the temptation to inflate ratings to attract issuers. Ratings contracts would be distributed depending on the accuracy of each NRSRO's historical rating record, thereby increasing competition and rewarding rating accuracy. Though these goals are worthy, the Franken Amendment is a poor idea on many levels. The fundamental reason for its creation was to try and prevent conflicts of interest and an oligopolistic paradigm within ratings, yet it addresses this by creating further conflicts of interest and a slightly broader oligopolistic paradigm.

In market practice the Big Three won almost 100% of the structured products ratings business leading into the financial crisis. The Franken Amendment will award business to other qualifying NRSROs that rate structured products too. This includes three other players at present. This means structured product ratings will now be shared around to six players instead of three, but issuers will still get ratings from one or more of the Big Three because they are the recognized names in the market. And, the Big Three can still rate these issues on unsolicited bases and award whatever ratings they would have otherwise. Ultimately, there is little initiative here other than a new issue subsidy redistribution to three more companies. Further, with business being awarded regardless of quality of rating, there will be little impetus for firms to innovate and improve.

[19] Franken, Al. The United States of America. *Restore Integrity to Credit Rating Amendment*. Washington D.C: , 2010. Web. 12 Jul 2011. <http://franken.senate.gov/files/docs/Final_Language_Franken_CRA.pDodd-Frank >. (3)

There are significantly more problems with the Franken Amendment:

- The Amendment gives the Commission power for determining the fees NRSROs can charge. But what happens to the firms if the committee decides to drop fees to an unpalatable level? For this or for any other reason if all the raters who rate an asset class decide to stop en mass, it would cause an international crisis of confidence.
- The amendment presupposes all ratings are the same and their providers are interchangeable. If this is the case, there will be no incentive for new players to innovate and there will be no incentive for the current players to improve
- An issuer that gets assigned a newer agency may disagree with the methodology or the philosophy of that firm's rating (not to mention outcome) and go to one of the Big Three in any event in addition. This will increase the issuer's gross borrowing cost
- Composing the committee will be a significant challenge as it will be full of conflicted parties themselves

Rapid Ratings Proposal for Increased Ratings Accuracy and Integrity

We would like to suggest an addition to the SEC's oversight process that we believe will have significant and meaningful implications to the rating industry reform effort. We would characterize this as a high potential benefit with low regulatory cost initiative. It is motivated by the following:

- Issuer-paid ratings have lost significant credibility
- There are potential conflicts of interest in the issuer-paid revenue model and many market participants believe ratings inflation is the result
- The issuer paid firms tend to have slow to change ratings, as described above
- The principal business model of issuer-paid firms is primarily issuance focused (where they get paid) and less on "maintenance" or "surveillance" ratings, where there is less money and more work
- The SEC has a challenge to oversee ratings performance and, if there are ultimately more NRSROs, this problem will become harder
- Whether we believe it should be or not, liability of ratings firms is an important element of legislative and regulatory reform initiatives

The proposal is both simple in concept and potentially wide reaching in its benefits: Require NRSROs to positively affirm by statement filed with the SEC that they stand by each previously issued rating on a quarterly basis or to make whatever ratings change is appropriate given the changed quality of issuer/security. If deemed to be too costly for the smaller NRSROs, an exemption could be granted with voluntary participation encouraged.

The potential benefits of this initiative are:

- Firms will not be able to hide behind the "our rating is good unless we say otherwise" positioning that permeates the market today
- Firms will have to properly reassure the market that their ratings have been reviewed and that the reputation of the firm is at stake continuously. Given the loss of confidence they have caused, it would be unwise for the Big Three to vehemently protest this initiative
- If a CRA will not attest to a rating on a quarterly basis, both the firm and the rating should be considered suspect
- At least one of the firms requires analysts to reaffirm the ratings for internal use only on a quarterly basis. This initiative would only be requiring them to make public these reaffirmations
- Potentially more ratings will be changed over time as their credit quality in fact changes, as opposed to having the agencies hide behind the rating through the cycle curtain
- Ratings volatility may increase slightly, but ultimately having asset managers responsible for understanding more frequent ratings changes instead of arbitraging stale ratings is a positive development
- Firms will have to think twice about their initial ratings given they will be responsible for attesting to its accuracy from there on out through time. Likely this will lead to less aggressive and more realistic initial ratings when/if there is a question in the minds of the ratings committees deciding on the initial level
- The SEC will have more data from which it can analyze rating agency performance
- If there are significant discrepancies among agencies on an individual security or company rating, the SEC will have the ability to check into the accuracy of the ratings, but in a targeted way highlighted to it from the NRSROs' attestation reporting
- This can be accomplished without an increased burden at the SEC and in fact can be accomplished electronically by pushing some oversight responsibility to the ratings firms themselves while overseen by the Commission

Conclusion

It seems clear the focus of Dodd-Frank was on controlling S&P, Moody's and Fitch with compliance, disclosure and the threat of liability. It was not on increasing the disclosure of information necessary to facilitate competition nor on the consequences of the Dodd-Frank provisions on current or prospective competitors.

The problem of the incumbent ratings paradigm cannot be legislated or regulated away. Only through the myriad efforts will we see meaningful change in this market: reducing investor reliance on NRSROs, removal of NRSRO references from statutes and regulations, increased access to data for analysis by competitors, facilitating not hindering new players, encouraging innovation, encouraging investors to evaluate various risk management factors in decision making combined with reasonable regulatory oversight, incumbent behavior modification and time.

Encouraging choice, and facilitating new players to bring this to the market unimpeded, will over time transform this industry. As case in point, Rapid Ratings' being shown to be 2.9 years ahead of Moody's in identifying companies that ultimately fail is the kind of innovation that is being embraced and will continue to decrease investors' reliance on the status quo.

We are pleased that this committee is taking the opportunity at this time to evaluate the state of affairs and consequences of Dodd-Frank on players such as Rapid Ratings and the effect on the industry overall. There is still much to do.

Thank you

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:**
James Howland Gellert	Rapid Ratings International Inc.
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: J H Gellert	

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