

**TESTIMONY OF DEVEN SHARMA  
PRESIDENT, STANDARD & POOR'S  
BEFORE  
THE UNITED STATES HOUSE OF REPRESENTATIVES  
COMMITTEE ON FINANCIAL SERVICES  
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS**

**JULY 27, 2011**

Chairman Neugebauer, Ranking Member Capuano, members of the Subcommittee, good morning. My name is Deven Sharma. I am the president of Standard & Poor's ("S&P") and have served in that capacity since September 2007. I am pleased to appear before you today.

While much has changed with regard to credit ratings and credit rating agencies over the course of the past several years, our fundamental mission at S&P remains the same: to provide the market with independent benchmarks about the creditworthiness of debt securities. Towards that end, at S&P, we have undertaken a variety of initiatives designed to strengthen our governance and control framework, to enhance the analytics and criteria we use to rate issues and issuers, and to clearly communicate the rationale behind our actions and better identify and report on key areas of risk in order to further transparency in the markets.

In that regard, while S&P has undertaken changes on its own, we have also supported, and adapted our processes to address, many changes that have occurred in the regulatory environment, both here and overseas. Through legislation and related rule-making, regulatory changes have reinforced and strengthened the integrity of the ratings process through increased oversight, greater transparency and accountability, and improved quality in analyst training. They have also addressed undue reliance on ratings by the market, particularly by removing legal requirements mandating the use of credit ratings — an effort S&P has long supported. S&P has taken major steps to meet these new regulatory expectations and integrate our reform initiatives into them. I will address these changes in my testimony.

***S&P's Credit Ratings:***

At the outset, I would like to take a moment to speak generally about S&P and our ratings process, as well as explain what ratings are and are not intended to convey. Over the course of

its history, S&P has sought to help create transparency in capital markets by providing independent credit benchmarks. Investors and other market participants have long turned to S&P for its credit risk assessment of companies and securities. By and large, private sector investors and other market participants use our ratings not because they are required to do so, but because our ratings provide valued perspectives they may use in their important deliberations about making investment decisions.

An S&P credit rating reflects our current view about the ability and willingness of an issuer to meet its financial obligations in full and on time. S&P's ratings are not statements of fact, but rather expressions of opinion about the likelihood that certain events will or will not happen in the future. S&P's ratings do not speak to what the market value of a security should be or the potential volatility of its price, both of which can be significantly affected by factors other than underlying creditworthiness. Importantly, S&P's ratings do not make recommendations to buy, sell or hold a security. Rather, they simply provide the market with a forward-looking view based on analysis that different market participants — whether they be investors, issuers, or regulators — may choose to use as part of their own assessment of the credit risks attendant to a particular security or entity.

S&P forms its ratings through quantitative and qualitative analysis performed by rating analysts applying analytical criteria that we publish to the market. These analysts gather information about a particular obligor or debt issue, analyze the information according to our criteria, form views about the information and then present their findings to a committee of analysts that votes on what ratings to assign. After a public rating is formed, S&P publishes it in

real-time and for free on our Web site, [www.standardandpoors.com](http://www.standardandpoors.com). S&P also generally publishes a narrative along with our ratings that provides detailed information about our opinion.

Our ratings are intended to convey a reasonably comparable view of creditworthiness across asset classes over time. That is, when we assign a particular rating to a manufacturing company, for example, we mean to connote that in our view the creditworthiness of that company is reasonably comparable to the creditworthiness of a telecommunications corporation receiving the same rating.

Our goal is to provide the public with timely, quality ratings and with insights and understanding as to the analysis that underlies them.

***Initiatives undertaken by S&P:***

Since 2008, we have undertaken a number of initiatives aimed at promoting four broad objectives: (i) ensuring the integrity and independence of the ratings process; (ii) enhancing analytical quality; (iii) providing greater transparency to the market by disseminating more information about ratings, as well as information to help investors form their own views of the soundness of rating analysis; and (iv) more effectively training our analysts and educating the marketplace about ratings.

We have made significant investments and enhancements to our internal processes and controls in these areas. Some examples include:

***Actions taken to ensure integrity and independence:***

- Investing significantly in our compliance and quality operations, including significant staffing additions;
- Establishing an independent criteria review and approval process. Our independent criteria team is now responsible for the approval of criteria;
- Establishing a Risk Assessment Oversight Committee, comprising senior leaders from various parts of S&P who are independent of rating teams, to identify and address current and emerging risks;

- Implementing a robust quality review program, through which independent quality officers review our analysts' compliance with procedures and policies;
- Supplementing existing controls against potential conflicts of interest. For example, in addition to our traditional use of a committee process and separation of commercial and analytical functions, we have also implemented "look-back" reviews and an analyst rotation program;
- Establishing an independent Policy Governance Group with a mandate to develop and approve all new ratings policies and procedures. This group is also responsible for maintaining policies that are clear, measurable, and consistent with our quality standards; and
- Increasing compliance oversight and training, including reinforcement of prohibitions on structuring or providing advice to issuers;

*Actions taken to strengthen analytics:*

- Adopting enhanced ratings definitions and updating our criteria across most major asset classes to map it to those definitions. This has enhanced ratings comparability across asset classes and across geographic regions as criteria is now calibrated to meet these more specific definitions. It has also led us on balance to look for stronger credit characteristics for securities seeking higher ratings;
- Creating an independent Model Validation Group with responsibility for reviewing models used in the ratings process; and
- Enhancing the ratings process with respect to data and information, as well as introducing additional analysis such as sensitivity scenarios;

*Actions taken to increase transparency:*

- Launching a new corporate Web site which provides easier access to credit ratings and various reports and articles, including criteria, relevant to the ratings process. In addition, the new Web site has enhanced search functionality;
- Enhancing disclosure of applicable factors and variables in our ratings reports of applicable criteria and the assumptions underlying our analysis; and
- Publishing a number of "what if" scenario analyses to provide the market with our views on the possible rating effects of potential scenarios before they occur;

*Actions taken on training and education:*

- Increasing analytical training and education of our analysts, and introducing a new Analytical Certification Program which our analysts fulfill in order to act as a primary analyst on a rating or to vote in a rating committee;
- Increasing the distribution of information about our ratings performance, as well as ratings transitions, via several newsletters the company publishes, as well as audio and visual presentations; and

- Publishing a “Guide to Credit Ratings Essentials” that provides important information about ratings and their role in the markets.

Let me assure you that the various improvements I have discussed are substantive and they have had a real impact on the personal and professional lives of our more than 1,300 analysts worldwide, with numerous additional analytical and process requirements, new controls throughout the ratings process and increased checks and oversight of their work. The organization, with added checks and balances as well as enhanced analytics, operates in a different way today. We have gone to great lengths to take serious and meaningful initiatives in the way we produce our credit ratings and we believe we are better serving investors, regulators, and the capital markets. S&P will spend over \$90 million this year in the changes we are making in our compliance and oversight framework; over the past 5 years, we have spent more than \$300 million. Historically, ratings have served as a valuable tool for evaluating the creditworthiness of issuers and debt securities. We believe firmly that with these enhancements in place our ratings will continue to be a meaningful part of the information available to investors and other market participants going forward.

***The Credit Rating Agency Reform Act and Related Rulemaking:***

Of course, the regulatory landscape for credit ratings has also undergone major change. The passage of the CRARA in 2006 established the first comprehensive regulatory scheme governing credit ratings, chiefly by establishing a registration and application system for those credit rating agencies seeking registration as a nationally recognized statistical rating organization (“NRSRO”). As detailed in that law, the NRSRO application requires the disclosure of a wide variety of information, including, among other things, information on the NRSRO’s procedures and methodologies for determining ratings; performance measurement

statistics for credit ratings; and a description of the NRSRO's policies for preventing the misuse of material, non-public information and for addressing and managing potential conflicts of interest.

The CRARA gave the Securities and Exchange Commission ("SEC") broad oversight and enforcement powers over NRSROs, through extensive examination and inspection authority, as well as the power to take disciplinary action against NRSROs — whether by censure, fines, or even revocation of their registration in certain circumstances. The CRARA also granted the SEC broad authority to promulgate rules implementing the new law. Thus far, the SEC has completed three waves of rulemaking which have resulted in a vigorous set of governing rules for NRSROs and the credit rating process.

The first set of SEC rules, which became effective in June 2007, addressed a number of topics. Under these rules, certain practices are prohibited outright, such as issuing ratings for entities that provided the NRSRO with ten percent or more of its net revenue in the most recent fiscal year, or conditioning the issuance of a credit rating on the purchase of other services or products provided by the NRSRO. The rules also require that certain practices must be disclosed and managed, such as the receipt of compensation for ratings analysis (from either issuers or subscribers) and the provision by NRSROs of non-ratings services to issuers. Extensive record-keeping requirements and disclosure to the SEC of financial information, including revenues received from large issuers, are also required under the initial rules.

In 2008, the SEC adopted a second wave of rules governing NRSROs. Among other things, these new rules require enhanced disclosures of ratings performance data, rating methodologies, and when certain ratings deviate materially from the output suggested by rating

models. The 2008 rules also prohibit NRSROs from rating an issuer or security if the NRSRO provided recommendations to the issuer; and from rating an issue or issuer if it receives gifts of more than de minimis value. Under a third set of rules adopted in 2009, the SEC requires NRSROs to facilitate the disclosure to other NRSROs of underlying data provided by issuers, so as to allow those NRSROs to issue unsolicited ratings on structured finance securities if they so wish.

The CRARA also empowered the SEC to conduct detailed and lengthy examinations of NRSROs' practices and procedures. In S&P's case, the first such exam began shortly after implementation of the 2007 rules and focused on its ratings of structured finance securities. The exam involved dozens of meetings and interviews and the production of a significant volume of documents. It resulted in recommendations which we have sought to implement on topics including staffing and resource levels, documentation of policies and procedures and potential conflicts of interest, and ratings analysis, including surveillance of existing ratings. A second SEC examination began in late 2010 and the results of this additional extensive exam are pending.

In practice, the CRARA has also lowered barriers to entry for other credit rating agencies to register as NRSROs, and several new NRSROs have been registered in recent years. New NRSROs include rating agencies that employ different business models, such as the "investor pays" model, and/or different processes and methodologies to determine their ratings. The result is an increase in the information and breadth of views available to investors in the market. In our view, this is a good development, and S&P welcomes the competition these additional NRSROs provide.

***Amendment of the CRARA by Dodd-Frank:***

The Dodd-Frank Act, signed into law just over a year ago, amends the CRARA to impose several new requirements on NRSROs which promote the quality and transparency of credit ratings as well as regulatory oversight of the ratings processes. S&P has been active in taking steps to comply with the Act. These steps include the formation of a new Board including independent members, which is charged with overseeing the establishment, maintenance, and enforcement of S&P's policies and procedures regarding credit ratings and conflicts of interest, as well as overseeing the effectiveness of our internal control system with respect to ratings policies and procedures.

Several other Dodd-Frank requirements — many of which S&P had already undertaken on its own initiative — and SEC powers are already in effect, or will go into effect pending on-going rulemaking by the SEC. These include:

- The separation of compliance functions from ratings and sales; maintaining separations between marketing and analytical activities; and look-back reviews when employees leave NRSROs to work for rated entities.
- Provisions directing NRSROs to consider any information they find “credible and potentially significant to a rating decision” as part of the ratings process.
- Provisions directing NRSROs to refer alleged securities law violations to authorities.
- Whistleblower protections: Federal whistle-blower protections are now extended to NRSRO employees.
- Elimination of Statutory References to Credit Ratings: Dodd-Frank requires that federal agencies review their use of credit ratings in rules and regulations, and that, within two years of enactment of the Act, statutory references to credit ratings be removed from several areas of federal law.
- Initial Credit Rating Assignments for Structured Finance Products: The SEC is studying the feasibility and advisability of a proposal which would establish an SEC-run assignment system for initial ratings of structured debt.

The SEC's rulemaking process is underway to implement the requirements of the Dodd-Frank Act, and S&P is reviewing those proposed rules closely as part of the public comment process.

***The Importance of Analytical Independence:***

We at S&P certainly share the goal of enhancing the transparency, integrity and quality of ratings and the ratings process. We also firmly believe that perhaps the most important value of ratings is their independence. At its core, a rating is an analytical determination. A group of knowledgeable and well-trained analysts, with years of experience working in the financial markets, sit down to analyze a set of facts together with historical information to develop a forward-looking opinion that others may use as a benchmark in connection with their own analysis. For the markets to have confidence in those ratings, they must ultimately represent the independent view of the rating agency. That means, of course, that they should be free of undue commercial considerations — and S&P is fully committed to that principle — but it also means that they must be free of undue regulatory or governmental influence as to their substance.

S&P supports a transparent system in which the market has the benefit of an NRSRO's complete and independent view of a bond or security, along with a clear understanding about the different aspects of creditworthiness that ratings do and do not address. This is far more beneficial to the market than a system in which the government mandates what a rating must mean or what it must account for. Similarly, the independence of rating agencies to develop their own methodologies, rather than be pushed by regulation toward a common methodology, mitigates the systemic risk that ratings could become indistinguishable from agency to agency. In a global economy where we rate more than 120 sovereign governments, it is particularly

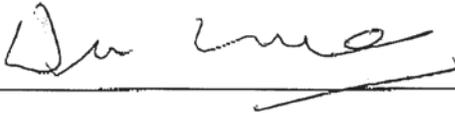
important that rating methodologies not become subject to influence by one or more countries seeking to benefit its own rating, which would undermine the independence, comparability and value of ratings to all. Accordingly, as rulemaking associated with the Dodd-Frank Act progresses, it is critical that new regulations preserve the ability of NRSROs to make their own analytical decisions without fear that those decisions will later be second-guessed if the future does not turn out as anticipated or that, in publishing a potentially controversial view, they will expose themselves to regulatory retaliation. Pressures of that sort could only undermine the significant progress we believe has been made over the years by rating agencies and regulators alike to provide the market with transparent, quality, and genuinely independent opinions about the creditworthiness of issuers and their securities.

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

### 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:
Deven Sharma	Standard & Poor's
3. Business Address and telephone number:	
	
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?
<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> 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	

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