

**Testimony of Sean J. Egan, Managing Director, Egan-Jones Ratings Company  
Before the House Subcommittee on Capital Markets, Insurance, and Government  
Sponsored Enterprises  
Nov. 29th Hearing – The Credit Rating Agency Duopoly Relief Act of 2005**

We support the proposed legislation (HR 2990) for reforming the ratings industry since it significantly increases competition in the industry.

The primary purpose of rating firms is to facilitate the allocation of capital by assessing the relative riskiness of various issuers. The job can be compared to the trucking industry in the sense that capital rather than goods, are moved throughout the financial system. Unfortunately, the regulatory process for the trucking industry makes a great deal more sense than does the regulatory process for the rating industry. In the trucking industry, there are various tests drivers need to take to ensure that they are able to operate vehicles in a safe manner. The tests are straight-forward, and passing them is similar to passing a driving test. In the ratings industry, there has never been a formal process for obtaining a license, and at the current rate there never will be. Regulators had been studying the area since the early 1990's and have yet to establish a set of requirements for applicants. Yes, two firms in the past couple of years have been recognized, but for the most part, the firms provide little competition to the major firms in the industry. (DBRS rates mainly Canadian issuers and AM Best focuses on insurance firms.)

In the trucking industry, if a shipper is unhappy with the rates or service of one particular shipper, there are a variety of other shippers available. In contrast, in the ratings industry there is relatively little competition. S&P and Moody's garner approximately 85% of the revenues for US corporate debt, and a rating from two firms is normally needed for a public issue. The costs for the lack of competition is borne by issuers, investors, employees, retirees, and non-recognized rating firms.

To address some of the concerns that have been raised about H.R. 2990 facilitating the emergence of a plethora of unqualified rating firms, we recommend the following additions to Section 3(a):

**Independence** - No NRSRO shall be affiliated with a broker/dealer, bank, financial institution, issuer, investor or user of credit ratings.

**Experience** – the rating firm shall have issued ratings for the past seven years and shall have generated at least \$1 million in revenues from such activities in the U.S. for a period of seven years or more.

**Quality** – to reflect the impact of events such as acquisitions, major share repurchases, and buyouts, all ratings issued will be reviewed using qualitative methods. Additionally, the NRSRO shall be available to issuers' personnel, and capable of reflecting issuer comments in ratings. Note, credit ratings based on security prices and spreads can easily be manipulated and provide profit opportunities to unscrupulous investors.

Regarding objections to HR 2990, below are rebuttals:

**H.R. 2990 Does Not Disrupt Markets** – increased competition should improve market conditions.

**H.R. 2990 Does Not Violate First Amendment** – additional competition should not effect First Amendment protection.

**H.R. 2990 Does Not Promote Rogue Firms** - additional competition should encourage the issuance of timely, accurate ratings.

Thank you for your time and interest. Attached is additional information on Egan-Jones.

Egan-Jones Ratings Company

## **Egan-Jones Ratings Co.**

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### **Information on Egan-Jones Ratings Co.**

We applied for the designation in July 1998 and have regularly issued timely, accurate ratings and provided warning for the Enron, Genuity, Global Crossing, and WorldCom failures (see the attachment). Furthermore, we consistently identify improving credits; most of our ratings have been higher than S&P's and Moody's over the past three years, thereby assisting issuers in obtaining more competitive capital. Our success has been recognized by the Federal Reserve Bank of Kansas City which compared all our ratings since inception in December 1995 to those of S&P and concluded:

“Overall, it is robustly the case that S&P regrades from BBB- moved in the direction of EJR's earlier ratings. It appears more likely that this result reflects systematic differences between the two firms' rating policies than a small number of lucky guesses by EJR.”

New York Times

Gretchen Morgenson (Pulitzer Prize Winner)

July 7, 2002

“Egan-Jones makes a practice of alerting investors to corporate credit problems well before they are acknowledged by management... As early as November 2000, for example, Egan-Jones cut its ratings on WorldCom to the lowest investment-grade level, citing its deteriorating profit margins and credit quality.”

Fortune's "Against the Grain"

Herb Greenberg

January 21, 2002

“The best balance-sheet snoops are often way ahead of the pack in finding signs of trouble. Sometimes, however, the big credit-rating firms, Standard & Poor's and Moody's, which get paid by the companies they rate, are slow off the mark--slower, as a rule, than independent bond-rating services like Egan-Jones.

Investment Dealers Digest (cover)

Dave Lindorff

August 13, 2001

“It didn't take long for Sean Egan, managing director of Egan-Jones Ratings Co., a small ratings agency outside Philadelphia, to figure out last fall's California power crisis would eventually put the state's utilities in a bind. “We saw a train wreck ahead for these companies,” recalls Egan, who says his analysts quickly fired off two reports to clients warning them of the troubles facing the state's two utilities-Pacific Gas & Electric Corp. and Edison International, the parent company of Southern California Edison. On Sept. 27, the firm lowered EIX's rating from A- to BBB-, and PG&E's rating from A to BBB+.”

Bloomberg News

Mark Gilbert

October 14, 2004

“S&P wouldn't be the first to pin a non-investment grade rating on Ford. Egan-Jones Ratings Co., a private company run by Sean Egan in Pennsylvania, cut the automaker's grade in January 2002.”

Grant's Interest Rate Observer

Annual Conference, October 2002

“The big two-and-a-half rating agencies have not exactly covered themselves in glory during the current credit debacles. Sean Egan, co-founder of Egan-Jones Ratings Co. (which saw many disasters coming before they landed in the newspapers), will discuss debacles and opportunities yet over the horizon.”

**NEXTEL's Senior Unsecured Ratings**

The bold indicates investment grade

	<u>Egan-Jones*</u>	<u>S&amp;P</u>	<u>Moody's</u>
07/16/2002	B+	B+	B3
08/29/2002	BB-	B+	B3
02/20/2003	BB	B+	B3
06/19/2003	BB+	B+	B3
7/21/2003	BB+	BB-	B3
7/22/2003	BB+	BB-	B2
11/26/2003	<b>BBB-</b>	BB-	B2
02/19/2004	<b>BBB</b>	BB-	B2
3/22/2004	<b>BBB</b>	BB+	B2
3/22/2004	<b>BBB</b>	BB+	B2
3/24/2004	<b>BBB</b>	BB+	B2
5/26/2004	<b>BBB</b>	BB+	B2
06/09/2004	<b>BBB</b>	BB+	B2
7/7/2004	<b>BBB</b>	BB+	Ba3
7/27/2005	<b>BBB+</b>	BB+	Ba3
8/10/2005	<b>BBB+</b>	BB+	<b>Baa2</b>
8/16/2005	<b>BBB+</b>	<b>A-</b>	<b>Baa2</b>

**Enron's Senior Unsecured Ratings**

The bold indicates non-investment grade

<u>Date</u>	<u>Egan-Jones*</u>	<u>S&amp;P</u>	<u>Moody's</u>
4/19/2001	BBB+	BBB+	Baa1
→6/27/2001	<b>BBB</b>	BBB+	Baa1
8/15/2001	BBB/ BBB- BBB+	BBB+	Baa1
10/16/2001	BBB/ BBB- BBB+	BBB+	Baa1 (neg.)
10/23/2001	BBB-	BBB+	Baa1 (neg.)
10/24/2001	BBB-/ BB+ BBB+	BBB+	Baa1 (neg.)
10/26/2001	<b>BB+</b>	BBB+	Baa1 (neg.)
10/29/2001	<b>BB+/ BB</b>	BBB+	Baa2 (neg.)
10/31/2001	<b>BB+/ BB</b>	BBB+	Baa2 (neg.)
11/1/2001	<b>BB</b>	BBB (neg.)	Baa2 (neg.)
11/6/2001	<b>BB</b>	BBB (neg.)	Baa2 (neg.)
11/7/2001	<b>BB-/ B-</b>	BBB (neg.)	Baa2 (neg.)
11/9/2001	<b>BB</b>	BBB- (neg.)	Baa3 (neg.)
11/21/2001	<b>BB/ BB-</b>	BBB- (neg.)	Baa3 (neg.)
11/26/2001	<b>BB-/ B+</b>	BBB- (neg.)	Baa3 (neg.)
11/28/2001	<b>B+/ B-</b>	<b>BBB-</b> (neg.)	<b>Baa3 (neg.)</b>
11/28/2001	<b>C/ D</b>	<b>B-</b>	<b>B2 (neg.)</b>
11/29/2001	<b>D</b>	<b>B-</b>	<b>B2 (neg.)</b>

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11/30/2001            **D**            **CC (neg.)**   **B2 (neg.)**  
 12/3/2001            **D**            **D**            **Ca**

\* Current and projected ratings

## WorldCom's Senior Unsecured Ratings

The bold indicates non-investment grade

<u>Date</u>	<u>Egan-Jones*</u>	<u>S&amp;P</u>	<u>Moody's</u>	<u>Action</u>
11/1/2000	A- (neg. watch)	A-	A3	EJR issued neg. watch (A-)
11/ 3/00	A- (neg. watch)	A- (neg. watch)	A3	S&P issued a neg. watch (A-)
11/17/2000				
0	BBB+ (neg. watch)	A- (neg. watch)	A3	EJR cut A- to BBB+ (neg. watch)
2/8/2001	BBB	A- (neg. watch)	A3	EJR cut BBB+ to BBB
2/27/01	BBB	BBB+	A3	S&P cut A- to BBB+
6/25/2001	BBB-	BBB+	A3	EJR cut BBB to BBB-
7/26/2001	<b>BB+ (neg. watch)</b>	BBB+	A3	EJR cut BBB- to BB+ (neg watch)
1/29/2002	<b>BB (neg. watch)</b>	BBB+	A3	EJR cut BB+ to BB (neg watch)
2/ 7/02	<b>BB- (neg. watch)</b>	BBB+	A3	EJR cut BB to BB- (neg watch)
2/ 7/02	<b>BB- (neg. watch)</b>	BBB+	A3 (neg. watch)	Moody's issued a neg. watch (A3)
2/19/2002	<b>B+</b>	BBB+	A3 (neg. watch)	EJR cut BB- to B+
4/12/02	<b>B+</b>	BBB+ (neg. watch)	A3 (neg. watch)	S&P issued a neg. watch (BBB+)
4/22/02	<b>B+</b>	BBB	A3 (neg. watch)	S&P cut BBB+ to BBB
4/23/02	<b>B</b>	BBB	A3 (neg. watch)	EJR cut B+ to B
4/23/02	<b>B</b>	BBB	Baa2	Moody's cut A3 to Baa2
4/25/2002	<b>B-</b>	BBB	Baa2	EJR cut B to B-
5/ 9/02	<b>B-</b>	BBB	<b>Ba2</b>	Moody's cut Baa2 to Ba2
5/10/02	<b>B-</b>	<b>BB</b>	<b>Ba2</b>	S&P cut BBB to BB
6/14/2002	<b>B- (neg. watch)</b>	<b>BB</b>	<b>Ba2</b>	EJR issues neg. watch
6/17/02	<b>B- (neg. watch)</b>	<b>B+</b>	<b>Ba2</b>	S&P cut BB to B+
6/20/02	<b>CCC (neg. watch)</b>	<b>B+</b>	<b>Ba2</b>	EJR cut B- to CCC (neg. watch)
6/20/02	<b>CCC (neg. watch)</b>	<b>B+</b>	<b>B1</b>	Moody's cut Ba2 to B1
6/26/02	<b>D</b>	<b>B+</b>	<b>B1</b>	EJR cut CCC to D
6/26/02	<b>D</b>	<b>CCC-</b>	<b>B1</b>	S&P cut B+ to CCC-
6/26/02	<b>D</b>	<b>CCC-</b>	<b>Ca</b>	Moody's cut B1 to Ca
7/ 1/02	<b>D</b>	<b>CC</b>	<b>Ca</b>	S&P cut CCC- to CC
7/17/02	<b>D</b>	<b>D</b>	<b>Ca</b>	S&P cut CC to D

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WORLDCOM INC WCOM 8 1/4 05/31 43.3307/ 44.2307 (19.16/18.78) BGN MATRIX

**Trade Line** WCOM 8 1/4 05/31 Corp 1/4

Range 10/30/01 - 4/30/02 Period D Daily

Chart: 1 Trade Line

Source  
1) News

