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Regulating Credit Rating Agencies

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Mr. Chairman, IOSCO member country representatives, honored guests, thank you for the opportunity to speak in front of you this morning. I am Vickie Tillman, Executive Vice President, Standard & Poor's, and the head of Standard & Poor's Ratings Services.

Many of you may already be familiar with my organization. Standard & Poor's is a leading provider of independent credit ratings globally. Our credit rating activities began in 1916. In the intervening 87 years, Standard & Poor's has rated hundreds of thousands of issues of securities, corporate and governmental issuers, and structured financings. Today, Standard & Poor's has credit ratings outstanding on approximately 150,000 securities issues of obligors around the world -- all of them based on or derived from a nearly century-long commitment to the highest standards of integrity, independence, objectivity, transparency, credibility and quality.

If these tenets upon which we base our work sound familiar to this audience, there is no coincidence. We recognize all too well that the value investors place on Standard & Poor's opinions depends, ultimately, on our reputation, a reputation we have to earn and re-earn in the marketplace every day. And protecting that reputation requires far more than having the right qualitative or quantitative methodology in place to arrive at the most appropriate rating.

As importantly, it requires ensuring that every rating decision arises from a process and a system that places as much emphasis on the values I just mentioned. Were it otherwise, the value that investors place on our ratings would suffer and in little time, we would be out of business.

I'd like to open my remarks by recognizing the attention that IOSCO has given to ratings and credit rating agencies over the past year, resulting in the IOSCO Technical Committee's recent Report on the Activities of Credit Rating Agencies and publication of a Statement of Principles.

In addition, I want to say how much we appreciate the Technical Committee's efforts to work with us and to receive our views as it developed an understanding of the ratings process. Certainly understanding our role and how our rating analysts gather and analyze information and formulate and disseminate credit opinions to the public based on that information is important and necessary in any dialogue that focuses on a system that has functioned extremely well over most of the last century.

Although part of my job this morning is to describe the business of Standard & Poor's Ratings Services, if you read the IOSCO report you are likely to get a far more comprehensive and eloquent summary of what an organization like ours does than anything I could describe in the ten minutes I've been allotted.

Suffice to say, I think the report reflects some of the fundamental aspects of our industry, including the absolute necessity for rating agencies to be independent and how Standard & Poor's ratings help markets evaluate and assess credit risk, price debt securities, benchmark issues and create a robust secondary market for those issues. I should add that, in addition to IOSCO, we have also made this point to securities regulators in the US, Canada, across Europe and the UK, as well as here in Asia.

The report also notes that our credit ratings are based principally on public information about an issuer; that once assigned, a rating is subject to ongoing surveillance; and that we do not perform an audit of the rated company or otherwise undertake to verify the information provided by the company. Rather, we rely on the integrity and quality of the company's publicly available financial reports and other information we receive on an on-going basis during the rating process.

Further, more detailed information about Standard & Poor's ratings, including our methodologies, can be found at our website, www.standardandpoors.com.

Where I would sound a word of caution with the report and the recently published principles that flow from it, however, is the inference that can be read into it that all credit rating agencies are somewhat the same and can therefore be lumped together; that a certain moral laxness might be missing in some rating agencies' business plans, especially those who receive fees from issuers; that the marketplace may not be doing a sufficient job regulating credit rating agency behavior; and that a higher standard or morality can or should be imposed by regulation or legislation.

Understandably, IOSCO's review is part of a much larger, world-wide initiative taken in response to significant evidence of accounting abuse, and in some cases fraud, that have undermined investor confidence across the globe. This increased incidence, some of it spectacular, has resulted in what some suggest are breakdowns or erosion in the accountabilities of the market's so called "gate keepers" or "watchdogs", labels we resist and roles for which we have neither the regulatory authority, nor the resources or the business model to play.

Understandably, over the past 24 months a number of national securities commissions, as well as IOSCO, have investigated and questioned the adequacy and integrity of the audit process, the effectiveness of corporate governance, the conflicts of interest inherent in the equity research function of many investment banks; the facilitating role of investment banking in creating balance sheet or income statement advantage out of complex accounting guidelines; and, for rating agencies, whether the process was vulnerable to conflicts of interest, abuse of confidential information or other dishonest or fraudulent conduct.

In the United States, the SEC undertook a review of rating agencies, including a series of public hearings in which issuers, investors, academics and the rating agencies participated. Subsequently, the SEC published in June of this year a concept release that posed 56 questions to market participants about the role and function on ratings or rating alternatives.

The concept release covered a full spectrum of issues relating to the role of the agencies but the main thrust of the document was on two questions: 1) should the SEC continue to designate nationally recognized statistical rating agencies for regulatory purposes and, if not, how should they be replaced in regulation; and 2) if the designation were to continue, what level of oversight should the SEC apply to Nationally Recognized Statistical Ratings Organizations.

Before I summarize how Standard & Poor's responded to the concept release, I'd like to mention a few observations on the role of the ratings industry arising from my 25 years in this business.

Number One: Rating agencies and Standard & Poor's specifically, have served capital markets extremely well by providing an effective, independent, objective opinion of creditworthiness. Our track record is strong and transparent, and readily available for the world to see in the default and transition studies we regularly publish. This role supports market discipline and efficient markets.

Number Two: As far as I am aware, in neither the research of the SEC, IOSCO, or any other security commission or legislative body has there ever been even the wiff of evidence or suspicion of market abuse on the part of the international rating agencies. Potential conflicts of interest inherent in our business model, i.e. collecting fees from the companies we rate, are effectively managed and there is no evidence of abuse or wrong-doing.

Number Three: Rating agencies must continuously adapt to changing market conditions in order to stay relevant. Again, my industry has a strong record in this area as well. As everyone in this room can attest, financial markets are one of the most innovative of all sectors and risk assessment and risk management has become increasingly sophisticated.

By way of example, at Standard & Poor's recent initiatives that demonstrate our responsiveness and anticipation of change include expanded liquidity analysis, the addition of accounting expertise, enhanced focus on corporate management and corporate governance, expanded training processes, the addition of more commentary around our ratings, and enhanced surveillance and analytic processes such as market price driven default and relative value modeling and related risk detection tools.

With this as background, we told the SEC this summer that Standard & Poor's did not seek the NRSRO designation, nor encourage it to use credit ratings for regulatory purposes; however we believe that any effort to withdraw all regulatory uses of the NRSRO, given no existing alternative for credit risk assessment, could risk disrupting markets.

Standard & Poor's also said that we support a more open and transparent NRSRO designation process. And, most importantly, that this process should continue to be based on market acceptance of the credibility and reliability of the rating agencies' opinions.

In addition, we noted that our concern that designation criteria based on measures such as diligence standards, rating disclosure mandates, record-keeping requirements, capital and other financial resource requirements could 1) interfere with the substance of the credit analysis and rating process; 2) compromise or be perceived to compromise the independence of rating agencies; 3) deter innovation, especially now given the pace of technology and quantitative analytics (regulation lags market development); and 4) result in homogenization of credit rating analysis through government prescribed minimum or uniform standards.

Ratings are subject to enormous market scrutiny everyday; they are constantly evaluated by issuers and investors. The market demands that our opinions be timely but also well considered, transparent and reflective of an operational infrastructure or system that, by needs and by tradition, must be open; independent and free from political or economic pressures and conflicts of interest (internal or external); and absolutely firm on maintaining confidentiality on all non-public information communicated by any issuer.

In summary, from the IOSCO report and in similar research published by the SEC, we see no demonstrated abuse or market failure that warrants creating additional regulatory requirements for rating agencies. Although I cannot speak for all, Standard and Poor's clearly recognizes our role and responsibility in capital markets – something that our employees and our policies take very seriously. Continuing this important role and extending the benefits of independent, credible rating services internationally depends on regulatory agencies providing a market environment that preserves the independence of credit rating agencies and recognizes the market as the best judge of a credit rating agency's quality, objectivity and independence.

Thank you.