WRITTEN STATEMENT OF S&P GLOBAL RATINGS

BOND RATING AGENCIES: EXAMINING THE "NATIONALLY RECOGNIZED"'
STATISTICAL RATING ORGANIZATIONS

HEARING BEFORE THE HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON
INVESTOR PROTECTION, ENTREPRENEURSHIP AND CAPITAL MARKETS

JULY 21, 2021

S&P Global Ratings ("S&P") appreciates the opportunity to provide this statement as part of the Subcommittee's hearing on "Bond Rating Agencies: Examining the 'Nationally Recognized' Statistical Rating Organizations." We understand that the Subcommittee is considering potential new legislation regarding the regulation of Nationally Recognized Statistical Ratings Organizations ("NRSROs"), and has invited certain market participants and commentators to participate in a dialogue with the Subcommittee about the potential costs and benefits of these new proposed legislative measures. We welcome the opportunity to be part of these important discussions and to provide our views on any proposed legislation, as we and other market participants have done in the past.

On the evening of Friday, July 16, 2021, the Subcommittee published a number of draft proposals that we understand are under consideration by the Subcommittee. As we have not had the opportunity to study these proposals in depth, we thought it would be most helpful to the Subcommittee to focus our statement on the role and recent performance of our credit ratings, the significant legislative and regulatory changes affecting credit rating agencies that have been adopted over the past 15 years, and our initial general thoughts on the legislative proposals under consideration. We welcome the opportunity to continue these discussions with the Subcommittee and to offer any additional views or comments as we continue to review these proposals.

The Role and Recent Performance of Our Credit Ratings

Credit ratings are forward-looking opinions about the creditworthiness of debt securities and issuers. At S&P, our credit ratings speak to our view of the ability and willingness of issuers to meet their financial obligations on time and in full. Our ratings provide market participants with a basis for comparison of the relative credit risk associated with different securities within and across asset classes. As forward-looking opinions, our ratings take into account, on a continuing

basis, relevant changes in market conditions, issuer-specific credit factors, and other events that could affect credit risk. As a result, our credit ratings can and do evolve over time to reflect our view of changes to issue and issuer credit risks.

As important as it is to understand the meaning of credit ratings and their utility to the financial markets, it is also important to understand what credit ratings are not. Credit ratings are not recommendations to buy, sell or hold a security. Credit ratings do not speak to other types of investment risk, the suitability of any particular investment, or the value or potential price volatility of a given security. Credit ratings seek to assess relative credit risk, but they are not guarantees of individual credit quality or absolute measures of default probability.

S&P is committed to providing the financial markets with timely, transparent, and high-quality credit ratings. As part of this commitment, we publish default and transition studies on an annual basis that show the performance of our ratings over time. As reflected in these studies, our credit ratings have performed well historically as effective measures of relative creditworthiness. The strong performance of our credit ratings has continued even through the unprecedented times of the global pandemic.

Legislative and Regulatory Enhancements Made Since the Financial Crisis

Over the past 15 years, including in the aftermath of the Financial Crisis, credit rating agencies have become subject to increased regulation both in the United States and abroad.

The current regime in the United States was established in part by the Credit Rating Agency Reform Act of 2006 ("CRARA"), which established a formal registration process and oversight for rating agencies designated by the United States Securities and Exchange Commission ("SEC") as NRSROs. At the outset of the Financial Crisis, CRARA was still very new and efforts to build out a comprehensive regulatory regime under the CRARA framework were only in their early

stages. Since then, the SEC has promulgated numerous regulations under the rulemaking authority granted to it under CRARA. Following the Financial Crisis, the regulation of credit rating agencies was further strengthened by the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") in 2010.

These legislative and regulatory actions have increased accountability, transparency and oversight of NRSROs. As a few examples, Dodd-Frank established corporate governance guidelines that require NRSROs to maintain a board of directors, including independent members, who are charged with overseeing the creation, maintenance, and enforcement of rating agency policies and procedures. Dodd-Frank mandated the creation of the SEC's Office of Credit Ratings, which performs annual examinations of each NRSRO that cover, among other topics, how each NRSRO manages conflicts of interest and whether each is following its ratings policies, procedures and methodologies. Dodd-Frank also enacted enhanced disclosure obligations and directed the SEC to implement rules that prohibit certain types of conflicts of interest outright, and mitigate others.

Since the Financial Crisis, and driven in part by the extensive requirements of Dodd-Frank, S&P has taken substantial steps and made substantial investments to further the quality, transparency and integrity of our ratings. Again, as a few examples, we have created cross-functional credit conditions committees ("CCCs"), composed of economists and senior analytical staff, for the purpose of enabling and promoting a consistent and systematic consideration of broader economic trends in our analytical processes and to identify macro vulnerabilities and risks. We established analytical oversight and consistency councils ("AOCCs") to oversee analytical excellence and comparability of credit ratings across asset classes and regions. We have enhanced our criteria and model development processes, implemented new policies and procedures to

mitigate potential influence from sales or marketing considerations, built out our global Compliance department, and established an internal control structure with dedicated personnel to strengthen governance and accountability.

Today, we are subject to comprehensive regulatory oversight in over 20 countries and the European Union. We believe this increased regulation of credit rating agencies in the United States and abroad has been effective in accomplishing the shared regulatory goals of the increased identification, disclosure and management of potential conflicts of interest and increased transparency about rating definitions, methodologies, and performance. While we believe it is important to monitor the efficacy of current regulation and consider potential ways to enhance that regulation as necessary and appropriate, we believe that in enacting any new legislation due consideration must be given to the significant changes to the regulatory landscape for credit rating agencies over the past 15 years.

Potential Legislation Concerning Increased Competition in the Credit Rating Industry

We understand that one of the underlying goals of potential new legislation would be to foster more competition in the credit rating industry. S&P has always supported the objective of increasing the number and diversity of views on credit risk in the marketplace and welcomes the opportunity to compete with existing and new NRSROs on analytical excellence. Increased competition was in fact one of the primary goals of CRARA, which recognized at the time that the two "largest credit rating agencies serve the vast majority of the market" and that "additional competition is in the public interest." Since the implementation of the registration and oversight system provided under CRARA, there are nine NRSROs currently registered with the SEC.

We understand that to further the goal of increased competition certain proposed legislation seeks to confirm that regulations that require a minimum credit rating allow for such requirements

to be met by credit ratings provided by any NRSRO registered with the SEC to issue credit ratings for the relevant asset class, and not just the ratings of the larger NRSROs. S&P has never advocated for the inclusion of its ratings in any regulation or guideline, and in fact has long supported efforts by Congress and regulators to reduce over-reliance on credit ratings by removing references to credit ratings from existing regulations. Nonetheless, if legislators and/or regulators choose to incorporate credit ratings in regulations, S&P sees no reason why any such minimum credit rating requirement could not be fulfilled by the ratings of any NRSRO that is registered to rate the relevant security or security issuer.

Potential Legislation Concerning NRSRO Compensation Models

We understand that concerns about conflicts of interest in the issuer-pays compensation model—the predominant model used by most NRSROs—have led to renewed interest in proposals for alternative compensation models. In the past, these proposals have included initiatives to ban or mandate a specific compensation model, to establish an independent board or other administrative process to assign the rating of new issuances to "qualified" NRSROs, and/or to implement a "rotation system" for the assignment of NRSROs. While we share the goal of mitigating conflicts of interest, we believe that these types of proposals present very serious costs and disadvantages to the market that have not been addressed in the proposal currently under consideration.

We believe the key to addressing conflicts of interest is not to ban or endorse a particular business model, but to identify, disclose, and manage conflicts while continuing to provide transparency to the market regarding ratings, rating methodologies, and rating performance. With transparency, market participants will remain free to choose the rating agency they consider to be the most qualified and experienced for a particular rating, and rating agencies will remain free to

choose how best to present their views to the market, whether free of charge to the entire investment community or on a subscription basis to those market participants who pay to receive the rating agency's ratings.

At S&P, we employ the issuer-pays model and believe that the advantages of this business model far outweigh the advantages of alternative models. A few primary advantages stand out: First, the issuer-pays model provides us with the resources necessary to deliver the quality and scope of credit ratings, analysis and surveillance that the markets demand. Second, the issuer-pays model has allowed us to ensure that all market participants, including retail investors, small community banks, and towns and municipalities, have access to our credit ratings in real-time, free of charge. Third, the widespread dissemination of our ratings subjects our ratings to analytical scrutiny every day from regulators, academics, the media, other rating agencies, sophisticated financial institutions, and others.

The current proposal would require the SEC to create a board to assign "qualified" rating agencies to rate corporate issuers. This proposal raises a number of concerns. First, it is not clear how the board would determine which of the many NRSROs, each of whom by definition have been accepted for registration by the SEC, is most "qualified" to rate a particular issuance. The current proposal suggests that qualification can be determined by looking to rating "accuracy" or the "effectiveness" of the NRSRO's methodologies. But any such measurements would almost certainly require an assessment of the substance of the NRSRO's credit ratings or the procedures and methodologies by which any NRSRO determines its credit ratings—subjects that the SEC may not regulate consistent with CRARA.[1] Moreover, an assignment system implemented by an SEC-created board could be viewed by investors as a government endorsement of the ratings resulting

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[1] 15 U.S.C. § 78o-7(c)(2).

from the system, notwithstanding any required disclaimer language. Any such perception would conflict with the separate and important goal of reducing reliance on credit ratings.

Creating and administering an assignment system also presents logistical difficulties. As required by Dodd-Frank, the SEC has spent significant time and effort studying the feasibility of establishing an assignment system for NRSROs in the structured finance area, and identified multiple concerns. Among other issues, the SEC cautioned that such a system "may be costly to implement and administer," may present an "operational complexity" that may impact "the quality of credit ratings and the functioning of the structured finance markets," "has the potential to create incentives that run contrary to the goal of ratings quality," and could pose other "unintended negative consequences."[2] Furthermore, to the best of our knowledge, no study has been conducted to date on whether requiring such a system for the assignment of ratings for corporate issuers, as the current proposed legislation contemplates, would present additional issues, particularly in light of the size of the corporate bond market. We believe additional study and careful consideration of the unique issues of the corporate bond market would be necessary before any such proposal is adopted to confirm that it does not pose additional unintended adverse consequences that would be detrimental to the market.

Finally, the current proposal also suggests that, at least initially, the board would assign NRSROs on a random basis or "rotation system." This effectively treats ratings as fungible commodities and incorrectly presumes that all ratings are of equal quality and utility. A random assignment system unfairly and inaccurately assumes that investors do not have their own views about the strengths and weaknesses of different rating agencies. But not all credit ratings are

[2] *See* SEC Report to Congress on Assigned Credit Ratings as Required by Section 939F of the Dodd-Frank Wall Street Reform and Consumer Protection Act (December 2012), at p. 74-75.

equally valued or trusted by the market and, as previously discussed, not all ratings speak to the same subject. Mandating the use of a particular rating agency by rotation, regardless of the preference of issuers or investors, could ultimately decrease the amount of useful information available to market participants, reduce the market's confidence in the resulting ratings, deter issuers from obtaining ratings on their debt, and result in less investor participation in certain debt offerings. In addition, a rotation system that allocates every rating agency an equal portion of rating mandates could also reduce the incentives for NRSROs to innovate, enhance and strengthen their models, criteria, and methodologies, or otherwise take steps to compete on analytical excellence.

Potential Legislation Concerning Expert Liability

We understand that the Subcommittee is considering a proposal that would nullify the November 23, 2010 no-action letter issued by the Division of Corporation Finance of the SEC (the "Division"), which stated that the Division would not recommend enforcement action to the Commission if an asset-backed issuer omits from its registration statement certain ratings disclosures required under Regulation AB (the "No-Action Letter").[3] It is our understanding that this legislative proposal is rooted in the premise that credit rating agencies are not subject to potential liability under the current federal securities framework. We believe this premise is inaccurate, and that any proposal that would nullify the No-Action Letter, without addressing the issues that gave rise to it, runs the risk of disrupting the financial markets.

Credit rating agencies are subject to potential liability under existing federal securities laws. In fact, Dodd-Frank changed the pleading standards for certain federal securities claims against credit rating agencies in an effort to made it easier for investors to bring such claims against

[3] http://www.sec.gov/divisions/corpfin/cf-noaction/2010/ford072210-1120.htm.

these potential defendants. Moreover, in recent years, credit rating agencies have been the subject of SEC enforcement actions, federal and state governmental actions, and private civil lawsuits, demonstrating that credit rating agencies can and do face potential liability for their credit rating opinions.

With respect to the specific issue of so-called "expert" liability under the Securities Act of 1933, credit rating agencies are treated like every other potential defendant under this law. Credit ratings agencies, like every accountant, engineer, or appraiser, can face potential Section 11 liability where such an "expert" consents to the use of a report or valuation prepared or certified by the expert in connection with a registration statement filed with the SEC. The only difference with credit rating agencies is that, historically, they have not consented to the inclusion of their credit ratings in registration statements. However, this stance is entirely consistent with the current stated legislative goal of reducing the over-reliance on credit ratings by market participants.

At one time, it was the policy of the SEC to encourage the inclusion of credit ratings in registration statements. SEC Rule 436(g) was promulgated to do just that, even without the consent of the relevant credit rating agency. Dodd-Frank rescinded Rule 436(g), reflecting a new legislative preference to no longer encourage the inclusion of credit ratings in registration statements filed with the SEC and to avoid the potential over-reliance by investors on credit ratings. S&P agrees with that position, especially given the fundamental difference between forward-looking credit rating opinions and other types of reports or valuations regarding current financial statements or other factual information that is typically included in registration statements filed with the SEC.

Neither the issuance, nor the proposed nullification, of the No-Action Letter changes anything with regard to potential liability for credit rating agencies under Section 11 of the 1933

Act. Rather, the No-Action Letter was aimed at the concern expressed by ABS issuers, and other market participants, as to whether and how issuers could properly comply with the rating disclosure requirements of Regulation AB if credit rating agencies would not consent to the inclusion of their ratings in registration statements. As the Division noted in its No-Action Letter, without allowing issuers flexibility with regard to the requirements of Regulation AB, "offerings of asset-backed securities would not be able to be conducted on a registered basis." Nullifying the No-Action Letter would simply return issuers back to the position they found untenable in 2010 and complicate, if not interrupt entirely, public offerings of asset-backed securities.

Potential Legislation Concerning the Identification of NRSROs in SEC Reports

We understand that the Subcommittee is considering legislation that would amend Section 15(E) of the Securities and Exchange Act of 1934 to require that the SEC identify by name any NRSRO referenced in any reports, studies, examinations or other communications to Congress or the public. Typically, and including in its annual reports concerning its examinations of the NRSROs, the SEC's Office of Credit Ratings ("OCR") publishes its findings without identifying the specific NRSRO that is the subject of the finding. It is our understanding that the purpose of this practice is to encourage openness and transparency in the relationship between OCR, as regulator, and the NRSROs it regulates.

It is not clear from the draft proposal what specific goal Congress may be trying to achieve by mandating a different practice. We think careful consideration should be given to identifying the specific aim of the draft legislation and whether there are more tailored alternatives that could accomplish that aim. Among other potential considerations, we believe that the Subcommittee should consider the purpose behind the current practice, the views of OCR as to whether a different practice may impede its oversight and regulation of credit rating agencies, the possible chilling

effect this proposal could have on communications between regulator and regulated entity, and whether the proposal may have a disproportionately negative effect on smaller or new NRSROs.

Potential Legislation to Mandate the Consideration of Climate-Related Risks

Finally, we understand that the Subcommittee is considering legislation that would require each NRSRO to create and publish a written policy on how the NRSRO will consider climate-related risks in its credit ratings and would further require the SEC to issue rules to carry out this requirement. We believe that Environmental, Social and Governance ("ESG") factors can and do influence the capacity and willingness of borrowers to meet their financial commitments and such factors have played a role in our creditworthiness assessments for some time. S&P also remains committed to providing transparency to the market as to how we incorporate ESG factors into our ratings methodologies and analytics.[4] Most recently, we issued a Request for Comment seeking market views on our proposed methodology articulating the principles that we apply to incorporate ESG credit factors in our credit ratings analysis.

Nonetheless, we are concerned that any legislation that effectively compels credit rating agencies to consider climate-related risks in their credit analysis or compels credit rating agencies to offer opinions on climate-related risks goes too far. Each credit rating agency should determine the factors it believes are relevant to the credit analysis underlying its rating opinions, provided that the credit rating agency is transparent to the market about such factors. No one should dictate the substance of credit rating opinions or the methodologies by which they are determined. In fact, as the current statutory framework provides, the SEC is specifically prohibited from doing so.

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[4] We have published a number of articles and studies describing how we incorporate ESG factors into our credit ratings. A collection of some of these materials can be found on our website at https://www.spglobal.com/ratings/en/products-benefits/products/esg-in-credit-ratings.

Rather than mandating that all credit rating agencies consider sustainability characteristics, we believe the better course is to ensure that each credit rating agency is transparent about how each considers ESG factors, if at all, in their credit rating opinions.

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In sum, S&P believes that recent legislative and regulatory initiatives have been effective in the regulation of NRSROs. We welcome the opportunity to continue discussing potential new legislation or enhancements to existing legislation but believe due consideration must be given to the substantial legislative and regulatory changes to this industry over the past 15 years and whether any new proposed legislation is carefully tailored to address a clearly identified issue, if any, with the regulatory framework as it exists today without posing unintended adverse consequences.