Standard & Poor's Commitment to Reform: Restoring Confidence in the Credit Markets

Deven Sharma, President, Standard & Poor's

The recent global financial crisis has proven beyond doubt that a new course of action is required. Here at Standard & Poor's, our business is no exception.

As the world's leading provider of credit ratings, S&P has experienced a period of intense scrutiny since the credit bubble burst two years ago. While the vast majority of the 32 trillion dollars of securities that S&P rates performed as anticipated, the performance of our ratings in the area of residential mortgage-related securities was a major disappointment. This is something that we at S&P deeply regret. We have learned important lessons from this experience, and we have made changes to our business. Today, S&P is a very different place than it was two years ago.

These changes have not been made in a vacuum. Because we provide important global credit risk benchmarks for investors, we have consulted closely with hundreds of investors, regulators, and legislators from around the world. We have also focused on implementing internal reforms to complement new regulations that have been proposed by the Obama administration, the Securities and Exchange Commission, European Union and other governments around the world.

Through this process, we have identified and undertaken four core reforms to restore investor confidence in our ratings.

First, we have further strengthened standards to prevent conflicts of interest. One source of concern has been the issuer pay model for ratings. At S&P, we understand there must be a clear separation between analysts who analyze securities and employees who negotiate issuer fees. In recent months, we have taken steps to strengthen this separation. We have established a new rotational system for our analysts. And when an analyst leaves to work for an issuer, we have mandated "look back" reviews to ensure the integrity of our prior ratings. We have also separated the quality, criteria and rating functions and established a Risk Oversight Committee. To further increase independence from issuers, S&P is exploring proposals for tying compensation to the performance of ratings over time.

To reinforce these practices, we created a new S&P Ombudsman earlier this year. The Ombudsman has the authority to bring unresolved matters directly to the CEO of McGraw-Hill and to the Audit Committee of the Board of Directors. The scope of the Ombudsman's work is open to the SEC, and to public scrutiny.

But more remains to be done. We believe that the new securitization reforms proposed by President Obama, along with regulatory initiatives in Europe and elsewhere, will help further reduce the potential for conflicts of interest. In addition to requiring ratings firms to bolster policies for managing and disclosing conflicts, these regulations will also require issuers to provide investors with stronger representations and warranties, along with fuller disclosure of loan-level data. These measures will improve the quality of the securitization process for investors as well as ratings firms.

Second, we have increased the transparency of our ratings process by publishing "what if" scenario analyses and sharing the risk factors that we consider when analyzing securities. With this information on hand, investors have a clearer understanding of the assumptions that underlie our ratings. If they disagree with these assumptions, they can act accordingly in the market.

Third, we have taken steps to improve our performance in an area where ratings firms have struggled in the past – structured finance. We have revised our criteria to incorporate a measure of stability into investment grade ratings and have published economic stress scenarios to be used as benchmarks for enhancing consistency and comparability of ratings across sectors and over time. And to ensure that our analysts in all sectors are fully prepared, we have partnered with NYU's Stern School of Business and American College Testing (ACT) to create a new, mandatory certification program.

Finally, we are responding to those who believe ratings firms should be more accountable for their performance to investors and regulators, beyond the market scrutiny our ratings and criteria receive on an ongoing basis. We support these calls for accountability. Like other market participants, ratings firms are already subject to securities fraud laws which prohibit us from knowingly issuing ratings that do not reflect our actual opinions. Under newly proposed legislation, the SEC would have the explicit authority to impose stiff punishments against firms that fail to meet regulations for disclosing conflicts of interest and ratings methodologies, similar to new rules in the European Union.

These new standards and regulations have fundamentally changed S&P, but our work is not complete. As countries continue adopting new regulations, we will continue working closely with policymakers to produce rules that are consistent around the globe. Ultimately, we envision a future when investors share the same safeguards wherever they put their money and when ratings agencies share a level playing field wherever they operate.

In the days ahead, we look forward to continuing our dialogue with investors. We are determined to earn back their trust. The people at S&P are dedicated to the highest quality standards and are committed to the revival of healthy and sustainable global credit markets. We measure our success by the benefits investors and issuers derive from ratings.

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