STATEMENT

of

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PRESIDENT & CEO,

REALPOINT LLC

at the

HEARING

on

ENHANCED ACCOUNTABILITY AND TRANSPARENCY IN CREDIT RATINGS

before the

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

of the

FINANCIAL SERVICES COMMITTEE

U.S. HOUSE OF REPRESENTATIVES

September 30, 2009

Washington, DC

Thank you for the opportunity to participate in this hearing. You have previously indicated that the Congress should “no longer pursue only modest modifications in regulating this problematic industry."[1] As one of the relatively accurate rating agencies, and with a business model very different than the other companies represented at this hearing, we agree with your assessment of the need for major changes in the *status quo*; however, we believe that this change should be accomplished by decisively and immediately addressing past abuses of the system by the larger NRSROs while simultaneously avoiding measures that (i) support their business models and control of the ratings business, (ii) restrict competitors and limit their growth with barriers to entry with impractical levels of liability and increased internal costs, and (iii) delay necessary action and thereby create uncertainty in the capital markets.

By way of background, Realpoint is the most recent company to be designated by the SEC as a Nationally Recognized Statistical Rating Organization (NRSRO). We were designated for asset-backed securities where our specialty is rating commercial mortgage-backed securities (CMBS). Realpoint is one of the five companies designated by the Federal Reserve Board as an eligible rating agency for these types of securities being issued under the Term Asset-Backed Securities Loan Facility (TALF), and, last week, we were added to the list of Approved Rating Organizations by the National Association of Insurance Commissioners.

The credit rating industry suffers from two fundamental problems. First, it is highly concentrated with two companies controlling 80 percent of the market and third company accounting for the next 15 percent. Second, market share has traditionally been maintained

[1] *Hearing on Approaches to Improving Credit Rating Agency Regulations*, 111th Cong. 1st Sess. (May 19, 2009).

by the restricted flow of information from the issuers and arrangers of debt offerings, which I have previously described in testimony before this Subcommittee. Essentially, these companies have been able to garner business without really having to compete on terms of either price or quality. In this situation, investors and the broader public interest are going to suffer as has indeed been the case.

Fortunately, companies like Realpoint have emerged in recent years using the subscriber-based business model where our revenues are primarily derived from investors, portfolio managers, analysts, broker/dealers and other market participants who pay on a quarterly or other recurring basis for our services. In this context, if we do not produce accurate, timely and independent ratings, we would lose our subscribers.

Under the currently dominant issuer-paid model, the record shows that the larger companies maintain market share despite poor ratings performance. Almost ten years ago, for example, the major rating agencies were assessing the debt of Enron, WorldCom, and Global Crossing at investment grade practically to the point at which these companies filed for bankruptcy. Yet, in the ensuing years, the profits of these same rating agencies rose and their market share remained unchanged. More importantly, there is no indication that the well-publicized failures of the major rating companies in asset-backed financing has resulted in any meaningful changes in industry practices or structure.

MARKET PROGRESS IN 2009

The credit crisis is far from over but we believe that the SEC's recent efforts are working, at least with respect to structured finance. New issues are creeping back into the market. As with the increased levels of confidence that are visible in other areas of the economy, investor confidence in CMBS is starting to return. This momentum needs to be sustained. One way to sustain it is to give investors choices in regard to their selection of rating agencies. It would be a mistake to legislate smaller NRSROs out of existence and force investors to rely on only a few, large NRSROs for ratings. A positive course of action at this time would be to allow the SEC to implement its most recently-announced changes.

Partly due to the SEC's actions, the structured finance market shows positive trends. Exhibit 1 hereto tracks changes in spreads for super-senior AAA CMBS from July 7, 2006 to September 25, 2009. CMBS spreads are currently 500-600 bp over swaps, well below their all-time highs of 900 and 1,100 bp over swaps from November 2008 through April 2009.[2] Current spread levels would be further reduced by the elimination of uncertainty in the market over whether changes other than those most recently announced by the SEC will be implemented.

Another positive development in the structured finance market, and in the markets generally, is the ability of REITs to de-leverage their assets. In 2009, REITs have been able to both reduce their near-term debt maturities, and raise capital through the equity markets.

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[2] From November 2008 through April 2009, CMBS spreads were at an all-time high, ranging between 900 and 1,100 bp over swaps. In May 2009, when the Fed announced that TALF would be extended to legacy CMBS, spreads tightened to about 600 bp over swaps. Unfortunately, spreads rose, by approximately 230 bp, on the news that Standard & Poor's was changing its ratings methodology and would downgrade 90 percent of super-senior AAA bonds from deals issued in 2007. When S&P softened its stance, some of the effect of its original announcement was mitigated. In June, the introduction of Re-REMICs further tightened spreads. Re-REMICs take AAA bonds with 30 percent subordination and structure them into two classes, one with a 50 percent subordination level. The added credit support drives demand from conservative investors. Since then, Spreads remain volatile in a range of 500-600 bp over swaps.

JOINT LIABILITY

We are very concerned about the proposal to make all NRSROs "jointly liable" for a civil judgment if the agency being sued is unable to satisfy the judgment. This is an unprecedented concept with respect to the inter-relationship of competing companies and it is particularly inappropriate for smaller companies like Realpoint to be guarantors for our multi-billion dollar competitors.

A related proposal essentially would require every agency to review and approve every other NRSRO's work. To do so, each agency would need to be an expert in every field and every methodology. Not only could we not afford to assume this liability, it would almost certainly result in the elimination of our current E&O policy.

FIRST AMENDMENT

The Discussion Draft seeks to reduce the First Amendment protections traditionally accorded to rating agencies by liberalizing "procedural" thresholds for private-sector litigation. In our view, this focus on First Amendment or "freedom of speech" defenses which have traditionally been accorded by the courts to credit ratings is counterproductive. At Realpoint, we offer and provide our research and best opinions regarding the likelihood of payment of a financial obligation, but we cannot be a financial guarantor on the $780 billion of CMBS we have rated. Whether or not the larger companies could manage that risk is for them to determine, but, in our view, the removal of the industry's liability protections is anti-competitive and would further support the existing oligopoly structure.

As the Committee is aware, various courts, State Attorneys General and other parties including the SEC are revisiting these legal concepts and it is clear that some changes are in the works. In a major development, a federal judge in New York has ruled preliminarily that this longstanding defense was inapplicable in a case being brought against a rating agency by the Abu Dhabi Commercial Bank.[3] Another relevant case was initiated by one of the nation's preeminent pension funds.[4]

We see no reason that the judicial process should be short-circuited by congressional action particularly in light of the fact that many of the pending cases are in the early stages at the trial courts. Moreover, while securities litigation has worked well for the plaintiffs bar, individual investors receive next to nothing from these cases and there is no conclusive evidence that there has been any significant deterrent effect. In the medical field as well, over half of malpractice expenses go to lawyers and administrative costs according to a 2006 study in the New England Journal of Medicine. Additional resort to the courts for effective remedy resolution is not what we need in the business community.

RATINGS SHOPPING

The Discussion Draft also seeks to redress ratings shopping by having the SEC adopt rules requiring issuers to disclose preliminary credit ratings from NRSROs on structured products as well as other forms of corporate debt. While attractive in concept, it is hard to see how such a requirement would be effectuated in practice since the early flow of

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[3] *Abu Dhabi Commercial Bank v. Morgan Stanley,*, No.CGC-08-7508 (NYSD).

[4] *See, e.g., California Public Employees' Retirement System v. Moody's Corp.*, No. CGC-09-490241 (Cal. Superior Ct. July 9, 2009).

information between the debt issuer/arranger and the credit rating agency is informal and primarily telephonic. Thus, any form of preliminary "trigger" would be difficult to prescribe and easy to avoid.

The Treasury Department has taken a strong position against "ratings shopping" through its support of legislation requiring that issuers and arrangers of credit provide all NRSROs with the same offering data so ratings can be prepared regardless of whether or not a specific NRSRO is hired on the transaction. On September 17th, the SEC adopted this concept by requiring any issuer or other sponsor of a structured security seeking a credit rating from an NRSRO to disclose the same financial information given to its solicited NRSRO to all other NRSROs designated to offer ratings for that particular type of security.[5] We deem this to be one of the most important reforms undertaken by the government in response to the credit crisis. The public benefits of having independent and qualified credit ratings, rather than just the two selected and paid by the parties selling the securities, are immediate and manifest.

OTHER ISSUES

We support the provision of the Discussion Draft requiring that each credit rating issued to the public include a disclosure of the fees billed to the obligor for the credit rating. Consideration should also be given to comparable disclosure for the regulated entities such as banks, insurance companies, mutual funds, pension funds and investment advisors insofar as the external ratings they use for federal and/or state regulatory purposes, i.e., whether or not

[5] SEC Press Release 2009-200 (September 17, 2009).

the ratings being relied upon were independent or paid out of the proceeds of the debt issuance.

The one-year prohibition on performing ratings for any issuer that has hired a former analyst at an NRSRO would significantly raise the costs of acquiring talented individuals since anyone who worked at an NRSRO would in effect be banned from working for an issuer for at least one year. Many individuals begin working at rating agencies for the training and experience provided with a view toward preparing for corporate work. Even people not planning this should be very hesitant to place this type of limitation on their career. Mobility is a keynote in the modern workplace and these types of limitations have the effect of hurting everyone's recruiting capacity vis-à-vis other financial services businesses.

The Discussion Draft would require all NRSROs to "publicly disclose information on initial ratings and subsequent changes to such ratings." These reports are to be made "freely publicly available" on websites and in written form when requested. Without a substantial time lag, this requirement is antithetical to the subscriber-based business model since selling this information is how we produce our revenues. Realpoint and other companies like it are able to produce independent and reliable bond-rating analysis because certain investors are willing to pay for it and these subscribers rightly believe that the information for which they are paying is not made freely available to others. Not only would disclosure requirements of this type undermine competition from the subscriber-paid companies, but some have argued that the mandate to make proprietary information freely available to the public may constitute a form of government taking.

The new requirements for independent directors and a Compliance Officer demarcated from ratings, marketing and other corporate functions may work for large, publicly-traded companies, but would penalize small companies seeking to expand their market presence. At Realpoint, we would certainly have to hire at least one new compliance officer due to these limitations on the person's other responsibilities.

The concept of the Compliance Officer reporting directly to the Board of Directors and having the Board approve analytical models methodologies are impractical for companies like Realpoint which employs approximately 50 individuals and has a board consisting of company officials and our start-up partners.

The Discussion Draft mandates that the SEC require NRSROs to adopt and use credit rating symbols that "distinguish" among structured products, non-structured products, corporate offerings and municipal offerings. Our experience it to the contrary; investors want to know that AAA means AAA, not whether one asset class is a real AAA whereas another asset structure represents a lower version of AAA.

CONCLUSION

As we have attempted to show with these various examples, the Discussion Draft and other well-intended remedial proposals have a common flaw, namely that the resolutions are aimed at two entirely different types of companies, with entirely different business models. Moreover, the market performance of Realpoint has been much more successful than the record of our larger competitors. For these reasons, our company is starting to gain some market traction. However, if the Congress applies a multitude of new rules, regulations and procedural controls on NRSROs which inevitably and disproportionately disadvantage smaller companies, the result is to punish the innocent and stifle the progress we have made to date.

In our view, the better remedy is to specifically address the two fundamental problems identified at the outset of my testimony: market concentration and ratings shopping. For example, one proposal which was suggested recently by Senator Charles Schumer (D-NY) which would require every 10th credit rating issued by an NRSRO have its second rating generated from a separate independent agency designated by the SEC.[6] As can be seen, the effect of this proposal would both diversify the market and limit the ability of issuers to steer business to preferred rating agencies.

At a minimum, we would suggest that the Congress follow the example used in the Sarbanes Oxley Act and apply the proposed new rules on internal controls and certifications on NRSROs which are publicly traded companies. Alternatively, the proposed remedies should be directed more precisely at the potential conflict that arises from the major rating agencies being paid exclusively by the issuers of the securities.

Mr. Chairman and Members of the Subcommittee, the SEC has taken an important step in this direction in mandating that the issuers' pre-sale and ongoing information on structured asset offerings be made available to all qualified rating agencies. However, this is only a first step. Competition can be further enhanced across the broader range of public offerings and by having securities, at least in part, rated co-equally by subscriber-based rating agencies.

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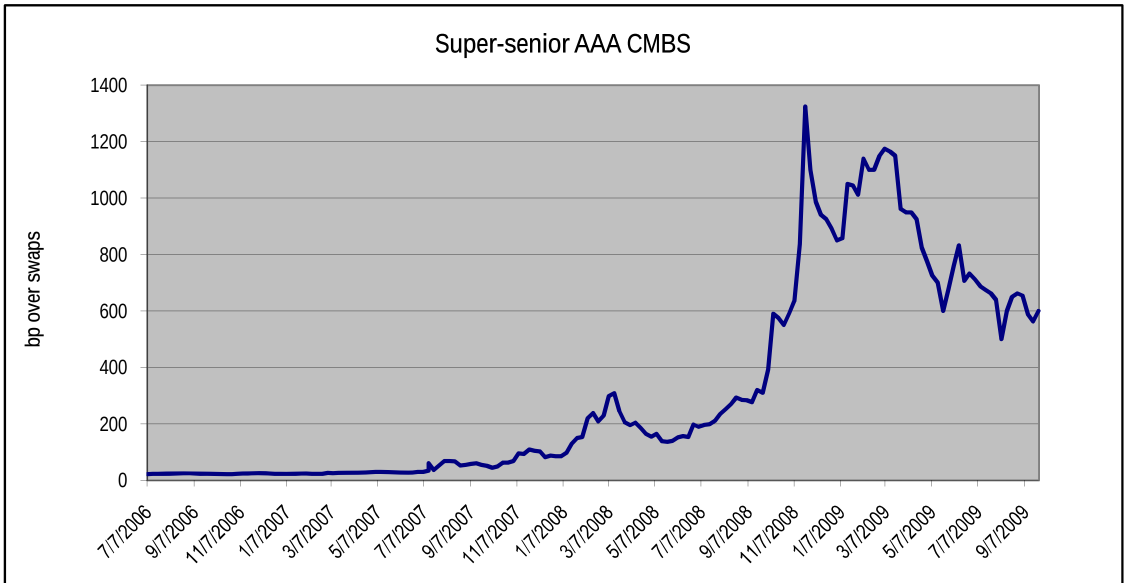
[6] Press Release: *Schumer Proposes New Backup Rating System to Keep Conflict-Riddled Credit Rating Firms Honest* (August 5, 2009).

Thank you for the opportunity to appear at this hearing and I look forward to responding to any questions you may have.

Exhibit 1



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