

**TESTIMONY OF VICKIE A. TILLMAN
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BEFORE

**THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE**

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Mr. Chairman, Mr. Ranking Member, Members of the Committee, good morning. I am Vickie A. Tillman, Executive Vice President of Standard & Poor's ("S&P") Credit Rating Services. I commend you for holding hearings to review important topics related to our increasingly complex financial system and appreciate the opportunity to appear before you today. I especially welcome the chance to highlight some of the actions that we at Standard & Poor's are implementing to enhance our ratings process. We have been listening hard to your views and those of various market participants, investors, other policy makers and external critics in the United States and globally, and we have been learning from current market events. Most importantly, we have made it our priority to take proactive steps to address the feedback received and issues raised.

In my testimony I would like to address two broad topics:

- The actions we are implementing to enhance our processes and promote confidence in our ratings; and
- The current regulatory situation both here in the United States and globally.

S&P's Actions To Enhance the Ratings Process and Promote Confidence

At Standard & Poor's, a core value of our company and key principle of our business is a constant commitment to improvement. Over the past several months, rating agencies have been the object of significant focus, including much critical attention. We have listened to, and reflected on, the numerous comments and concerns and have focused our efforts to

enhance our ratings process, provide better and more information to investors, and promote confidence in our ratings. The result has been a series of actions -- announced in February of this year. The actions focus on raising transparency — providing the market with greater insight and understanding of the analytics and information supporting the ratings so investors can make better informed investment decisions — as well as Standard and Poor’s rating practices and processes. I have attached to my testimony a detailed description of those actions that includes an update we published earlier this month outlining the significant progress we have made in implementing the actions and our plans for further implementation going-forward. Many of these initiatives are either already underway or scheduled for roll-out this year.

In total, our actions include 27 different initiatives, which fall into four broad categories:

1) Governance — The first category of actions relates to our governance procedures and controls. These actions are designed to enhance the integrity of our ratings process and to safeguard against factors that could challenge that process. Among other things, they include:

- Establishing an “Office of the Ombudsman” to address concerns related to, for instance, potential conflicts of interest, including potential conflicts that may arise from the fact that we are paid by issuers. The Ombudsman will be independent of the business, reporting to the Audit committee of The McGraw-Hill Companies’ Board of Directors and the public.

- Requiring periodic reviews of our compliance and governance processes by an independent external firm.
- Establishing an independent “Risk Assessment Oversight Committee” responsible for analyzing risks that might affect the ratings process as well as assessing the feasibility of rating new types of securities.
- Implementing “look back” reviews when analysts leave to work for an issuer. This review is designed as a safeguard against undue influence by issuers in the ratings process.
- Implementing periodic rotations for lead analysts. The purpose of this policy is to help prevent long-standing professional or personal relationships from affecting ratings.

2) *Analytics* — The second category of actions focuses on the substantive analysis we do in arriving at our ratings opinions. These actions are designed to enhance the quality of our ratings analysis. Among other things, they include:

- Enhancing our surveillance process through increased resources, ongoing separation from new rating and rating surveillance activities in Structured Finance, expanded use of search and market based tools, and other measures.
- Establishing an independent “Model Oversight Committee” to assess and validate the quality of models used in our analysis.

- Increasing annual analyst training and certification requirements.
- Complementing traditional credit ratings analysis by highlighting non-default risk factors that can influence the valuation and performance of rated securities and portfolios of rated securities, such as market liquidity, volatility, correlation and recovery.

3) Information — The third category of actions addresses the information we use in our analysis and the information we provide to the public. These are designed to provide greater insight to market participants. Among other things, they include:

- Presenting “what if” scenario analysis in rating reports to explain key rating assumptions and the potential impact of positive or negative events on the rating.
- Working with market participants to improve disclosure of information regarding collateral underlying structured finance securities.
- Implementing procedures to collect more information about the processes used by issuers and originators to assess the accuracy and integrity of their data and their fraud detection measures so that we can better understand their data quality capabilities.
- More broadly disseminating ratings-related data, including default statistics. S&P has long made available — for free — detailed transition and default studies about our ratings. The studies cover our ratings across sectors, from corporate ratings to structured finance to

public finance. This initiative is designed to promote broader dissemination of that information to the markets. For example, on March 31, 2008, we distributed free of charge a multimedia videocast addressing our most recent annual corporate default and transition study to roughly 30,000 institutional investors and other market participants.

- Developing an identifier to the ratings of securitizations that will highlight to the market when: (a) a rating is on a securitization, and (b) a rating is on a new type of structure or securitization;
- Making available a report of “Landmark Deals” which summarizes new structures and major issues, and distributing the report widely to investors, intermediaries, issuers, regulators and media;
- Developing an early warning indicator to investors that a key credit quality attribute (*e.g.*, delinquencies or losses) of an issue or issuer differs from our expectations and has or may trigger a full review by S&P surveillance.

4) Education — The fourth category of actions relates to our efforts to educate the market about ratings, their role, and their limitations. The goal of these actions is to increase understanding in the marketplace about credit ratings and rated securities. Among other things, they include:

- Publishing a *Credit Ratings User Manual & Investor Guidelines* to promote better understanding of the ratings process and the role of ratings in the financial markets.
- Launching a market outreach program to promote better understanding of complex securities that S&P may rate.
- Establishing an “Advisory Council” with membership that includes risk managers, academics and former government officials to provide guidance on addressing complex issues and set topics for market education.
- Working with other NRSROs to promote ratings quality through the introduction of best practices and issuer disclosure standards.

As we have discussed with Members of this Committee, we have been working aggressively to implement these actions and have been meeting with legislators, regulators, and market participants in the United States and globally to gather feedback. I would also emphasize that these actions are in addition to the practices and policies we have in place to address the integrity and quality of ratings. While we believe these address the concerns we have heard from this Committee, we welcome further suggestions as to how we can enhance market confidence and continue our tradition of quality ratings that offer opinions on creditworthiness to the market.

U.S. and Global Regulatory Situation

As the Committee is aware, Standard & Poor's and other NRSROs operate in a global financial market, and just as we have engaged with market participants and government authorities here at home, we have also reached out to similar groups around the world. Many of the concerns raised globally reflect those in the United States, and I would like to briefly review for the Committee the status of some of these efforts.

First, here in the United States, the SEC has been working on two fronts since passage of the *Credit Rating Agency Reform Act of 2006* (CRARA). As the Committee is aware, the regulatory regime established under that law was the product of several years of consideration and, in our view, reflects a judicious balance between oversight and analytical independence. The SEC's implementing rules for CRARA took effect on June 26, 2007, less than one year ago, and the first SEC examination under the new regime started in late 2007. That examination is still in progress. Its scope is extensive and the SEC staff has been extremely active and thorough in their work. The SEC exam is focusing on the very issues that have been at the heart of the concerns expressed by market participants and policy makers, and we look forward to the SEC's completion of its work. We are committed to addressing any recommendations that the Commission may have following its review process.

Another important development on the policy front was the March 10th release of the *Policy Statement on Financial Market Developments* by the President's Working Group on Financial Markets (PWG). That report addresses a number of potential measures or reforms in the financial industry, including some relating to credit ratings. A good number of the PWG recommendations are consistent with our announced actions. S&P fully supports the Working Group's efforts to bring greater transparency, stability and confidence to the capital

markets and we look forward to working with the PWG to help drive the effective functioning of the credit markets.

On the international front, the International Organization of Securities Commissions (IOSCO) has undertaken a review of its *Code of Conduct Fundamentals for Credit Rating Agencies*. Just this past March, IOSCO published for comment a series of possible proposed changes to its model Code, after extensive consultation among IOSCO members, credit rating agencies (CRAs), representatives of the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, issuers, and the public at large. We are reviewing the IOSCO proposals currently and will be submitting our comments in the coming days.

In Europe, the Committee of European Securities Regulators (CESR) released a consultation report in February of this year, entitled *The Role of Credit Rating Agencies in Structured Finance*. The consultation report sought comments on some of the results of CESR's market survey. The consultation report also sought views regarding the regulatory regime in Europe. Among the areas covered in the report are: transparency of rating processes and methodologies; monitoring of rating performance; CRA staff resourcing; and conflicts of interest.

S&P is also considering the recommendations made by the Financial Stability Forum (FSF) in its recent report. S&P has been engaged with FSF members and we will continue our dialogue on their suggestions. As with other international initiatives, we look forward to working with the FSF on consistent global approaches to key issues.

Both on its own, and as part of an informal industry working group of participating CRAs, S&P is committed to remaining engaged in these processes — just as we have been in response to

our U.S. policy makers. We expect that, in the next eight weeks, IOSCO will finalize its proposed amendments to the IOSCO Code and CESR will present its recommendations to the European Commission. The report issued by FSF indicates that the Forum will consider further steps mid-year. Once these recommendations are finalized, we will review them carefully and move swiftly to re-assess our processes and procedures and adopt, as appropriate, additional measures to conform with the final recommendations of those organizations.

Conclusion

I thank you for the opportunity to participate in this hearing. Over the past several decades, S&P's consistent approach has been to evolve our analytics, criteria, and review processes when appropriate, and you can expect that same approach going forward. Let me also assure you again of our commitment to analytical excellence and our desire to continue to work with the Committee as it explores developments affecting the subprime market. I would be happy to answer any questions you may have.



Progress Update

S&P's steps to further manage potential conflicts of interest, strengthen the ratings process, and better serve the markets

GOVERNANCE: Ensuring Integrity of the Ratings Process

Establish an *Office of the Ombudsman* that will address concerns related to potential conflicts of interest and analytical and governance processes that may be raised by issuers, investors, employees and other market participants across S&P's businesses. The Ombudsman will have oversight of the handling of all issues, with authority to escalate any unresolved matters, as necessary, to the CEO of The McGraw-Hill Companies and the Audit Committee of the Board of Directors.

- We have begun a search for candidates and will appoint an Ombudsman by year-end.

Engage an external firm to periodically conduct an independent review of S&P Ratings' compliance and governance processes and issue a public opinion that addresses whether S&P is effectively managing potential conflicts of interest and maintaining the independence of our ratings.

- We are finalizing and implementing relevant policies and are in the process of identifying a firm to conduct the independent review. We anticipate engaging a firm for this review by the end of next year.

Hold periodic reviews with the Audit Committee of the McGraw-Hill Board to discuss S&P Rating's overall governance and compliance functions. The reviews will include: (1) key business measures of ratings quality and compliance effectiveness, (2) the concerns and resolution of issues addressed by the Office of the Ombudsman, and (3) results of the independent reviews, by an external firm, of S&P Ratings' overall governance and compliance processes.

- Review meetings have begun. Meetings will be held three times a year with the McGraw-Hill Audit Committee and once a year with the full Board. Additional meetings or follow-up will be scheduled as requested or necessary.

Formalize functions with responsibility for policy governance, compliance, criteria management and quality assurance of the ratings and make them separate and independent from the ratings business units.

- We have established an independent Policy Governance Group (PGG) with the mandate to develop and approve all new Ratings' policies and procedures. This group is also responsible for the maintenance of policies that are clear, measurable and maintain our standards of quality. PGG membership includes representation from legal and compliance teams as well as the Analytical Policy Board.
- We continue building out our compliance department with additional staff and resources to implement risk-based monitoring of key policies that manage potential conflicts of interests, and enhance compliance training.
- We have reorganized the criteria and quality review functions, increased staffing dedicated to these functions, and have made them independent from the ratings business units. Guidelines for the activities and reporting of the criteria quality review function and process were enhanced. Training has been initiated on new criteria review processes.

Establish an enterprise-wide *Risk Assessment Oversight Committee* that operates separately and independently of the ratings business. The Committee will assess all risks that could impact the ratings process. This committee will also assess the feasibility of rating new types of securities.

- Established the Standard & Poor's Enterprise Risk Oversight Committee ("SPEROC"). SPEROC has the responsibility to provide critical risk assessment of business strategies and plans, employ appropriate assessment and monitoring of existing and emerging risks, and evaluate risk policies and controls. Regularly scheduled meetings have begun.

Implement "look back" reviews to ensure the integrity of prior ratings, whenever an analyst leaves to work for an issuer.

- We have developed a framework for look back review procedures. The reviews are expected to begin by mid-year 2008.

Institute periodic rotations for lead analysts.

- We have commenced a rotation program for our analysts. Additionally, the Structured Finance practice will be limiting lead analysts' exposure to specific arrangers, and potentially issuers, based on a number of factors that may include: (i) a maximum time period for lead analysts who handle a given arranger or issuer relationship, (ii) a maximum number of ratings assignments per period involving the same arranger or issuer, or (iii) a maximum number of consecutive ratings assignments involving the same arranger or issuer.

Increase the level of existing employee training to ensure compliance with policies.

- We've improved access to key Ratings' policies and Codes of Conduct by adding an icon to analysts' desktops.

- We are enhancing our global compliance training, which is scheduled for completion in Q3 2008.
- We are developing new modules that enhance our on-line training courses and reinforce key policies for analysts. The new modules will be available to analysts in Q3 2008.

ANALYTICS: Enhancing Quality of Ratings Analysis and Opinions

Improve the surveillance process through: (a) additional resources and ongoing separation of new rating and rating surveillance functions in Structured Finance (b) strengthen surveillance in Corporates & Governments through the expanded use of search and market based tools and through oversight of surveillance separate from the business, and (c) regular adding of surveillance tools to make the surveillance process more timely and effective.

- In Structured Finance Ratings, we:
 - Have increased our RMBS Surveillance staff
 - Are integrating RMBS loan specific data into our credit and cash flow models
 - Are incorporating new capabilities gained as part of acquisition of iMake, a leading global provider of structured cash flow models and data.
- For Corporate & Government Ratings, we:
 - Have developed a market pricing monitor to alert analyst to credits trading outside our expected range
 - Have deployed text-based search tools for U.S. corporate issuers' filings.
- We continue to identify and evaluate additional methods of improving surveillance and will update the market as they are implemented.

Establish a *Model Oversight Committee* within the Quantitative Analytics Group, which will be separate from and independent of the business unit, to assess and validate the quality of data and models used in our analytical processes.

- We have hired a Senior Director of Model Quality and have staffed and established the group.

Increase annual analyst training requirements, enhance training programs and establish an analyst certification program.

- We have developed an enhanced training curriculum and increased our annual analyst training requirements by 25%.
- We are evaluating third-party firms to establish an independent credit analyst certification program. We expect development of this program to begin by year-end 2008.

Complement traditional credit ratings analysis by highlighting non-default risk factors such as liquidity, volatility, correlation and recovery, that can influence the valuation and performance of rated securities and portfolios of these securities.

- We have identified a list of non-default risk factors and will begin market validation in Q2 2008. We have requested feedback from market participants by mid-year and will commence research coverage by year-end 2008.

INFORMATION: Providing Greater Transparency and Insight to Market Participants

Simplify and provide broader market access to ratings criteria, underlying models and analytical tools.

- We are improving users' ability to search our free public website for S&P criteria documents. This enhancement will be available by mid-year 2008.

Include "what if" scenario analysis in rating reports to explain key rating assumptions and the potential impact of positive or negative events on the rating.

- We are developing a framework for including "what if" scenario analysis in all of our initial ratings reports. We anticipate including this information in all CMBS, CLO, U.S. RMBS, and U.S. Auto Loan reports by year-end.
- We have already included this analysis in the following reports:
 - The Potential Effect Of Rate Freezes On S&P-Rated U.S. First-Lien Subprime RMBS
 - Ford Credit Auto Owner Trust 2008-A
 - Reviewing The Impact Of Rate Freezes On Rated U.S. First-Lien Subprime RMBS Under Two Scenarios
 - U.S. Credit Card ABS Is Expected To Withstand Higher Losses in a Recession

Improve the quality and integrity of information by working with market participants to improve disclosure of information on collateral underlying structured securities. In addition, implement procedures to collect more information about the processes used by issuers and originators to assess the accuracy and integrity of their data and their fraud detection measures so that we can better understand their data quality capabilities.

- On transactions closing after May 1, 2008, we are requesting updated loan level performance data from issuers on a monthly basis, consistent with data customarily sent to Trustees and third party data vendors in the U.S. RMBS market.
- We are in the process of revamping criteria for assigning overall mortgage originator rankings based on operational process and procedures. New criteria will be established by mid-year 2008.

- We are evaluating various fraud tools and detection policies used by originators for improved data integrity and will be incorporating these evaluations in the criteria to be established by mid-year 2008.
- We continue to identify other actions and will notify the market as they are implemented.

More broadly disseminate long- and short-term rating performance data.

- We have broadened distribution of this data to regulators, legislators and other market participants.
 - For example, we have produced a multimedia videocast, discussing the key highlights of S&P's most recent annual corporate default and transition study. The videocast and study were distributed free of charge on March 31 to roughly 30,000 institutional investors and other market participants.

Better explain the comparability of ratings across asset classes/issuer types (structured vs. corporate vs. government).

- Our goal is to continue to provide credit ratings that are reasonably comparable measures of creditworthiness across all major sectors and their sub-sectors. S&P uses the same rating scale across the structured finance, corporate and government sectors, including public finance to express our rating opinions. We will continue to publish data and articles on the subject of ratings comparability.

Make available a Landmark Deal Report which summarizes new structures and major issues, and distribute the report widely to investors, intermediaries, issuers, regulators and media.

- We will begin publishing Landmark Deal Reports in Q3 2008.

Enhance access to S&P's code of ethics and disclosures through a link to the Global Regulatory Affairs section of www.standardandpoors.com.

- We are designing a new link on our website to more easily access important regulatory information. The link should be available by mid-year 2008.

Establish greater minimum portfolio disclosure criteria for structured securities servicers (e.g. ABCP and SIVS).

- By mid-year 2008, we will publish new, key data items about the portfolio of every ABCP conduit and SIV we agree to rate. This increased disclosure will provide investors additional insight into the investments and risks of these entities and a better understanding of what assets underlie their investments. This will include asset metrics such as sector concentrations, key ratings dependencies such as credit support and liquidity providers, and liability metrics with regard to outstanding liabilities of the issuer.

Develop an early warning indicator to investors that a key credit quality attribute (e.g. delinquencies; losses) of an issue or issuer differs from our expectations and has or may trigger a full review by S&P surveillance.

- We have introduced new early warning indicators.
 - We are publishing Synthetic Rating Over-Collateralization (SROC) monthly for all synthetic collateralized debt obligations. SROC is a key indicator of potential rating change.
 - We have launched the Ratings Review Triggers product for European RMBS.
- We will continue to look for additional methods of improving transparency and update the market on our actions.

Develop an identifier to the ratings of securitizations that will highlight to the market that: (a) the rating is on a securitization, and (b) the rating is on a new type of rating structure or securitization.

- We have developed a proposal for the identification of securitized ratings. We will publish a request for comment by mid-year asking for feedback. An update on next steps will be provided by Q3 2008.

EDUCATION: More Effectively Educating the Marketplace about Credit Ratings and Rated Securities

Publish a *Credit Ratings User Manual and Investor Guidelines* to promote better understanding of the ratings process and the role of ratings in the financial markets.

- S&P plans to distribute on its website a Ratings User Manual and Investor Guidelines in Q3 2008.

Broaden distribution of analysis and opinions via web and other media.

- We have broadened distribution of this data to include regulators, legislators and other market participants.
 - For example, we have produced a multimedia videocast, discussing the key highlights of S&P's most recent annual corporate default and transition study. The videocast and study were distributed free of charge on March 31 to roughly 30,000 institutional investors and other market participants.
 - We are improving users' ability to search for our criteria on our website. We are on schedule to release this enhancement by mid-year 2008.

- Released new RMBS Product Distribution Platform (available via <https://www.sp.sfproducttools.com/sfdist/>), which includes all of S&P's publicly available Residential Mortgage Backed Securities models
 - Launched update of CDO Interface (available via <https://www.sp.cdointerface.com/CdoOnlineWeb/login.htm>), which provides greater transparency through increased reporting functionality and improved access to European and Asia/Pacific deal research
- We will continue to look for additional methods of broadening the distribution of our analysis and opinions and update the market on our actions.

Launch market outreach program to promote better understanding of complex securities S&P rates.

- We have recently begun meeting with Chief Investment Officers at top investment firms to discuss ways in which we can provide greater transparency on the complex securities we rate.
- In addition, S&P has recently expanded the production and distribution of its free podcasts and videocasts to provide broader market access to the perspectives of S&P's analytical staff.
- We will continue to look for additional methods to promote a better understanding of the complex securities we rate.

Establish an Advisory Council with membership that includes risk managers, academics and former government officials to provide guidance on addressing complex issues and establish topics for market education.

- We are identifying and recruiting members for an Advisory Council. We will begin meetings by year-end 2008.

Work with other NRSROs to promote ratings quality through the introduction of industry best practices and issuer disclosure standards.

- Standard & Poor's is part of a working group, together with other SEC-registered NRSROs who choose to participate. This group is responding to matters of regulatory concern, as appropriate, and implementing industry-wide proposals to help restore confidence in the credit rating industry.
- S&P is also working with the American Securitization Forum and other trade groups and industry organizations to establish best practices for disclosure in securitizations.