Statement of
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Committee on Banking, Housing and Urban Affairs

Turmoil in U.S. Credit Markets: The Role of the Credit Rating Agencies

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Introduction

Fitch Ratings traces it roots to the Fitch Publishing Company established in 1913. In the 1920s, Fitch introduced the now familiar "AAA" to "D" rating scale. Fitch was one of the three rating agencies (together with Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's") first recognized as a nationally recognized statistical rating organization (a so-called "NRSRO") by the Securities and Exchanges Commission (the "Commission") in 1975.

Since 1989 when a new management team recapitalized Fitch, the company has experienced dramatic growth. In 1997, Fitch merged with IBCA Limited, another NRSRO headquartered in London, and became owned by Fimalac, a holding company that acquired IBCA in 1992. The merger of Fitch and IBCA represented our first step to respond to investors' needs for an alternative global, full-service rating agency capable of successfully competing with Moody's and S&P across all products and market segments.

Our next step in building Fitch into a global competitor was our acquisition in April 2000 of Duff & Phelps Credit Rating Co., an NRSRO headquartered in Chicago, followed by the acquisition later that year of the rating business of Thomson BankWatch. These acquisitions especially strengthened our coverage in the insurance industry.

Fitch currently covers 6,000 banks, insurance companies and other financial institutions, 1,700 corporations, 105 sovereigns and 94,000 municipal offerings in the United States. In addition, we cover over 9,000 structured finance securities.

Testimony

The past ten months have seen continuing deterioration in first the U.S. and then global fixed income markets. Severe asset quality deterioration in the U.S. subprime market and related CDO securities initially caused large market price declines that required revaluations of those securities by financial institutions because ultimate credit losses are now expected to be far greater than anyone had anticipated. Today's market stresses, however, have become more broad based and emanate from a global reassessment of the degree of leverage and appropriateness of short-term financing techniques inherent in today's regulated and unregulated financial companies. Deleveraging is dramatically reducing liquidity and contributing to price volatility. Many financial market participants are seeking ways to enhance stability.

Fitch's contribution to a better functioning market requires a reassessment of the changed risk environment, rating changes that reflect the changes in risk, ratings that are more stable and reliable, an improvement in our analysis and modeling techniques and full transparency so investors and all market participants can understand and use our ratings to supplement their own risk analysis and decision making.

Like all of the major rating agencies, our structured finance ratings have not performed well and have been too volatile. We have downgraded large numbers of structured finance securities, particularly in the subprime mortgage and CDO areas, in many cases by multiple rating notches. While we still expect almost all AAA securities to pay off, we have downgraded many, and some previously highly rated securities are at a high risk of incurring losses in the future.

While we were aware of, and accounted for, the many risks posed by subprime mortgages and the rapidly changing underwriting environment in the U.S. housing market, we did not foresee the magnitude or velocity of the decline in the U.S. housing market nor the dramatic shift in borrower behavior brought on by the changing practices in the market. We also did not foresee and are surprised by the far-reaching impact the subprime crisis has had on markets throughout the world.

Understandably, the rating agencies have lost some confidence of the market for which I am very disappointed. I think it will be a long and difficult road to win back market confidence. We have, however, aggressively started down that road and believe that we are making progress, albeit slowly.

To win back investor confidence we simply must do a better job with our structured finance and other ratings. Our structured finance ratings must be more predictive and stable. Our research and analysis must be more insightful and forward-looking. We must tell the investor about what might happen tomorrow instead of what has happened yesterday. We of course remain committed to ensure that our work is of the highest integrity and objectivity.

We have reevaluated our ratings across all areas of structured finance and the financial services industry as the credit turmoil has progressed. We are working hard to anticipate what may be next and to address any issues as quickly as we can while maintaining a balanced perspective and avoiding overreaction to these trying times.

Fitch has also been busy reassessing our structured finance criteria and models - changing them to reflect what we have observed in this turmoil. It has been our belief that we will best serve the market by concentrating our efforts on improving our ratings, our criteria and our models before anything else. As we conduct this work, we have decided to stop rating new issues in some structured finance markets that have experienced some of the greatest turmoil, such as CDOs. We will remain out of these markets until we can assure the market and ourselves that we have adequately updated our models and criteria to reflect what we have observed through the turmoil.

The world's financial infrastructure has become intricately interconnected and it seems as a result that credit ratings have become increasingly important to many market participants. Unfortunately, we have come to learn that ratings have been used by some as a proxy to measure liquidity and market risk, which ratings were never designed to address. Accordingly, we must do a better job at providing ratings and additional tools that allow investors to better assess risk in this increasingly complicated environment.

We have also been busy working with the other rating agencies, including Moody's and S&P, to increase the transparency and quality of ratings and to address the various concerns of regulators and market participants throughout the world. As an industry, the rating agencies have been in active dialogue with world regulators and trade groups about improving what we do.

Here in the U.S., we have been cooperating with the SEC in their extensive examination of our practices and procedures. The SEC began a formal examination of Fitch in September and a staff of SEC examiners has been working with our staff during the past seven months as they work to complete their examination. The SEC staff is conducting their examination under the oversight authority granted to them by the Credit Agency Reform Act of 2006. I believe that the market and the rating agencies will benefit from the oversight authority that the Reform Act gave to the SEC.

The examination process has been thorough and will prove to be very constructive to the SEC as it undertakes the important work of considering new rules about credit ratings and the credit rating agencies. We support their efforts to improve the transparency, integrity and quality of ratings and we believe their work will aid us in our efforts to win back investor confidence.

Fitch also has been actively meeting with the staff of this Committee and the staff of the House Financial Services Committee, both of which have taken leadership roles in understanding the market turmoil and introducing measures to help alleviate the turmoil. Since last spring, we have been meeting regularly with the staff of the Treasury Department, the various Federal bank regulators, state insurance commissioners, state and local officials and investors, both large and small, to share our perspective with them, and to gain insight from them, on the variety of ways the turmoil has affected the market.

We will continue to engage in these dialogues and we stand ready to adopt the various proposals of such groups as the Financial Stability Forum and other international regulatory bodies that are designed to improve the independence, transparency and quality of Fitch's credit rating process.

I thank you for the opportunity to testify and look forward to answering your questions.