TESTIMONY OF KATHLEEN A. CORBET

BEFORE

THE UNITED STATES SENATE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

APRIL 23, 2010

Mr. Chairman, Members of the Committee, good morning. I am Kathleen A. Corbet and, from April 2004 until my voluntary departure in September 2007, I served as President of Standard & Poor's ("S&P"), a division of The McGraw-Hill Companies, Inc. ("McGraw-Hill" or "MHP").

I want to start by acknowledging the important work of the Subcommittee, and Congress as a whole, in looking into the recent financial crisis with the goal of understanding its causes and consequences and, importantly, working to avoid the recurrence of similar market disruptions and resultant economic downturns. I appreciate the opportunity to appear today to offer my perspective on, and answer the Committee's questions regarding, the role of credit rating agencies in the recent financial crisis.

It is difficult not to feel personally touched by the pain experienced by many as a result of the turmoil in the subprime market and the financial crisis that followed. It is similarly clear that the economy as a whole has been affected by these events. Many people feel anger, and that anger is understandable. It is my fervent belief, therefore, that we should collectively use this crisis -- and the lessons from it -- to focus on effective reforms, stronger investor protections and better industry practices and accountability.

S&P's Organizational Structure and My Responsibilities as President

As background, prior to joining S&P, I spent more than 20 years in executive leadership in investment management companies with a focus on fixed income portfolio management, trading and research for institutional and mutual fund investors located throughout the world. Starting in late 2003 I was recruited to lead the Financial Services division of MHP and assumed the position of President of S&P on April 12, 2004. Financial Services was one of three business divisions of McGraw-Hill along with Education and Information & Media. The Financial Services division, known more commonly as Standard & Poor's or S&P, is the world's foremost provider of financial market information including ratings on over $30 trillion in global debt securities, independent equity research on over 2,000 companies, market indices -- including the world's most referenced index, the S&P 500 -- risk evaluations and data and analytic tools.

During my three-year tenure as President of S&P, my primary role was to lead an organization of 8,000 employees located in 23 countries to ensure that the firm continue its mission to provide knowledge, insights and analysis about the financial markets and to expand upon that mission through global organic growth and strategic acquisitions. The company was organized along four primary business units, led by seasoned executives who, in at least three cases, had over three decades of experience at S&P and/or in the relevant field. Each of these executives had direct operating responsibility for his or her business line including 1) Rating Services; 2) Equity Research Services; 3) Data & Information Services; and 4) Index Services, reporting directly to me. In addition to the four business lines, the heads of Finance, Technology, Marketing & Communications, Regulatory Affairs, and Human Resources reported to me with dotted-line reporting to their counterparts at MHP, with the exception of Regulatory Affairs and Human Resources which reported on a solid-line basis to MHP.

There were three executive-level positions within S&P that are important to highlight in the context of the Subcommittee's focus. First, from 1999 until 2009, the Ratings Services business was led by Vickie A. Tillman, an Executive Vice President. Ms. Tillman joined S&P in 1977 as a municipal analyst and took on increasing levels of responsibility throughout her tenure including as Executive Managing Director of Standard & Poor's Structured Finance Ratings in

1994. In this role, she assumed worldwide operational and financial responsibilities, directing rating activity for all S&P Structured Finance Ratings Services until her promotion in 1999 to lead S&P's Ratings Services.

Second, concurrent with Ms. Tillman's promotion and tenure as head of Ratings Services, Ms. Joanne Rose was appointed in 1999 as Executive Managing Director of Global Structured Finance Ratings. In this role, Ms. Rose oversaw S&P's ratings business with respect to all structured finance securities including, asset-backed securities, residential mortgage-backed securities, commercial mortgage securities, collateralized debt obligations, and surveillance. Ms. Rose served in this capacity as a direct report to Ms. Tillman until January 2008 when she was named Executive Managing Director for Risk Quality & Policy at S&P.

Third, in October 2006, Mr. Deven Sharma, who had previously served as an Executive Vice President and Head of Global Strategy at MHP, joined S&P to head the three "Non-Ratings" businesses and Global Sales for all of S&P, reporting directly to me. In August 2007, Mr. Sharma was named as my replacement and today serves as President of Standard & Poor's.

It is important to note that, within the Ratings Services business, Ms. Tillman had her own direct reports including senior executives responsible for individual segments of the global debt markets. For instance, within the Global Structured Finance Services segment led by Joanne Rose, each structured debt category was overseen by a senior manager coupled with layers of organizational oversight. To illustrate, Ms. Susan Barnes who, from mid-2005 until 2008, headed the group responsible for rating U.S. RMBS securities, reported to a global practice leader for all ratings on asset backed securities who in turn reported to Ms. Rose.

The organizational structure in its entirety facilitated effective management of approximately 8,000 employees and allowed for specialization of expertise. Specifically, ratings were assigned by committees of analysts who specialized in a particular industry (in the case of corporate ratings) or a particular asset class (in the case of structured finance) and those groups in turn were headed by executives who themselves had expertise in that specific area. My role as President of S&P involved a number of responsibilities, including setting and implementing S&P's overall strategy, addressing regulatory issues, executing strategic acquisitions and global partnerships, working with the parent company MHP, and communicating with the market.

Consistent with S&P's long-standing -- and publicly disclosed -- practice, ratings decisions are solely the province of committees comprised of experienced analysts in the relevant area. It is a core S&P principle that the highest quality analysis comes from the exercise of independent analytical judgment free from both undue external and internal pressure, particularly since ratings analysts typically possess the most detailed knowledge and relevant experience on the issues. As a corollary, S&P's Index Services business also operates under a committee-based decision process to determine appropriate constituents and other factors which contribute to the design of a published index. Accordingly, during my tenure, I did not participate in any rating or criteria committee meetings regarding ratings, including ratings on securities backed by subprime mortgages, and would refer the Subcommittee to the testimony of Ms. Barnes and Mr. D'Erchia for detail on S&P's ratings process and criteria for mortgage-backed securities.

S&P's Ratings on Subprime RMBS

S&P has long been recognized as a leader in the ratings industry with a strong track-record in offering opinions about the creditworthiness of issuers and securities. That said, it is clear that a number of the ratings S&P issued on securities backed by subprime mortgages performed poorly and at odds with historical expectations, in some cases dramatically so. S&P has publicly stated its profound disappointment with that performance and I deeply share that sentiment.

While I have not been directly involved with these issues since my departure from the company, from my personal perspective, I believe the primary reason why these ratings have performed poorly is that -- despite rooting its analysis in historical data -- S&P's assumptions simply did not capture unprecedented phenomena that later occurred with respect to the housing market, borrower behavior, and credit correlations. While S&P's analysts did, for example, factor the possibility of a significant decline in home prices into their analysis, the depth and breadth of what subsequently occurred was indeed much greater.

S&P, along with others, has been criticized for its failure to predict what happened in the subprime market and, in many ways, that criticism is justifiable. Still, to me, these recent difficulties also highlight the challenges inherent in the nature of ratings. At their core, ratings are opinions about what may happen in the future, specifically the likelihood that a particular security may default. Predicting the future is always difficult and events can turn out very differently than even the most carefully derived predictions anticipate. The key is to learn from these experiences and take measures to improve. For example, I think it's constructive that S&P has revised its rating criteria to incorporate a measure of stability into investment grade ratings and believe that its published economic stress scenarios should serve as improved benchmarks of sector consistency and comparability over time.

In my view, it is imperative that the rating agency industry communicate clearly to the market regarding ratings analysis and the trends that could affect those ratings. This transparency and communications efforts were principles I sought to emphasize at S&P during my tenure. From my industry experience, I felt it particularly important that S&P be more sensitive to the market's needs and to communicate through timely published reports, teleconferences, meetings with the investor community, and through other outlets. This included communications regarding what S&P was observing in the subprime sector and the housing markets more generally. Some examples of these communications include:

- A September 13, 2005 article, entitled *Simulated Housing Market Decline Reveals Defaults Only in Lowest-Rated U.S. RMBS Transactions*, in which S&P published a study concerning the potential impact of a housing downturn on RMBS that assumed, among other things, a 20% national decline in home prices over a two-year period and an increase in unemployment to 6.5%. The results of the study indicated that S&P's existing models largely captured the risk of a downturn of this magnitude and that most investment-grade RMBS would likely not suffer a credit-rating downgrade.

- A January 19, 2006 article, entitled *U.S. RMBS Market Still Robust, But Risks Are Increasing And Growth Drivers Are Softening*, in which S&P informed the market of its belief "that there are increasing risks that may contribute to deteriorating credit quality in U.S. RMBS transactions; it is probable that these risks will be triggered in 2006."

- A May 15, 2006 article, entitled *A More Stressful Test Of A Housing Market Decline On U.S. RMBS*, in which S&P reported on the results of a follow-up analysis to the September 2005 housing price simulation referenced above assuming an even more stressful economic environment. The conclusion of this study was that, while some downgrades in lower-rated investment-grade bonds would likely result, higher rated bonds, including 'AAAs', would likely experience little deterioration due to their heightened credit enhancement levels.

- A January 26, 2007 *Transition Study: U.S. RMBS Upgrades Are Down And Downgrades Are Up In 2006*, in which S&P reported that for 2006 "[d]owngrades overwhelmed upgrades for subprime mortgage collateral" and that S&P expected "losses and, therefore, negative rating actions to continue increasing during the next few months relative to previous years."

- A March 22, 2007 article, entitled *A Comparison Of 2000 and 2006 Subprime RMBS Vintages Sheds Light On Expected Performance*, in which S&P compared RMBS deals issued in 2006 (the 2006 "vintage") to the worst performing vintage on record at that time, the 2000 vintage. S&P stated its expectation that the 2006 vintage was likely to experience more severe losses than the 2000 vintage.

As reflected in these public statements, S&P was monitoring subprime and housing market performance throughout this period and expressed increasing concern as performance data accumulated. S&P also took a series of actions, including tightening its criteria and taking unprecedented CreditWatch and downgrade actions throughout 2006 and the first half of 2007. In July 2007, growing concerns over subprime performance led S&P's analysts to modify their criteria further and take more significant downgrade actions. While I did not make the analytical decisions that led to the ratings actions during these periods, given the magnitude and importance of the issues and the public attention being paid to this sector, I did seek to understand the trends the analysts were seeing and their approach to them. I was also involved in S&P's communications efforts around these events given the previously noted importance of transparency.

Additional Topics Raised by the Subcommittee

The Subcommittee has asked me to comment on the role played by investment banks in the ratings process. While I do not recall meeting with any investment banks or their representatives regarding S&P's ratings during my tenure and therefore do not have direct perspective regarding this issue, I do know that investment banks can play a variety of roles in connection with the issuance of debt securities. Depending on that role and the nature of those securities, investment banks might interact with rating agencies in a variety of ways. An investment bank, for example, may be an advisor to a party issuing debt and seeking a rating. It may also be an underwriter of those securities. In other contexts, an investment bank may seek a rating for itself as in issuer of securities.

The Subcommittee has also asked me to address the potential conflicts of interest arising out the "issuer pays" model traditionally used by many rating agencies as well as the measures in place at S&P to guard against that potential conflict. As an initial matter, I should note that I believe there is room in the market for rating agencies that have both the "issuer pays" business model and the "subscriber pays" model and that competition in the industry has a beneficial effect on investor choice and analytical quality. For full disclosure purposes, since January 2009, I have been a private equity investor in Rapid Ratings International, Inc. -- an independent ratings, research and analytics firm that provides financial health ratings of companies for investment and risk management professionals. Rapid Ratings operates on a subscription or "user pay" business model. Underscoring my belief that both models can serve the financial market information industry, I also remain an investor in the publicly-listed stock of MHP.

During my tenure -- and indeed long before and since -- S&P employed an "issuer pays" model. As with any business model in which one party pays another, the "issuer model" has inherent potential conflicts of interest. In order to manage such conflicts, S&P had -- and I believe continues to have -- a number of policies and procedures in place. For example:

- Ratings were assigned by rating committees, not by individual analysts;

- Analysts were not compensated based upon the ratings assigned to, or fees received from, the issuers they covered;
- Negotiations with issuers about fees or other business matters were handled by commercial personnel, not ratings analysts; and
- Analysts were prohibited from engaging, directly or indirectly, in any S&P activities with respect to non-ratings businesses, including any cross marketing of non-ratings services.

It is my understanding that S&P has enacted additional measures in this area in recent years. Based on S&P's public announcements, some of the more noteworthy initiatives from my perspective include:

- Appointing an Ombudsman to address complaints or concerns raised either internally or from external sources;
- Increased investment in its compliance function;
- Implementation of "look-back" reviews of analysts' work whenever an analyst leaves to work for an issuer;
- The institution of a mandatory analyst rotation program.

Conclusion

Through many cycles in the financial markets, the credit ratings industry has played an important and, in my view, mainly beneficial role in the financial system for nearly a century. A key reason has been its ability to learn lessons from unexpected market events and to enact improvements. These improvements should come both from the industry itself and from sensible and appropriate regulatory reform. As painful as recent events in the financial markets have been for everyone involved, these difficulties also present an opportunity to enhance the functioning of our markets, including the role of rating agencies.

On a more personal level, despite the unflattering -- and in many cases inaccurate -- media reports, it has been a privilege to serve in my broad and various roles within the financial services industry over these last 25 years. I have always strived to lead and serve with integrity and purpose for the common good. Indeed, these core principles and life experiences continue to sustain my active engagement in corporate, civic and philanthropic organizations and, perhaps more importantly, through public speaking and teaching about the lessons learned in this significant moment in history to my children and future generations of leaders.

Again, I appreciate the goals of the Subcommittee's work and would be glad to answer any questions you may have.