

**Written Testimony of Angela Liang
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**Hearing – “A Notch Above? Examining Bond Rating Industry”
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets
House Committee on Financial Services
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Chairman Sherman, Ranking Member Huizenga and members of the subcommittee, thank you for the opportunity to testify today. I am testifying on behalf of Kroll Bond Rating Agency, LLC (KBRA) in my capacity as the firm’s General Counsel and Executive Committee Member.

KBRA is a global, full-service rating agency established in 2010 after the financial crisis and registered with the Securities and Exchange Commission (SEC) as a Nationally Recognized Statistical Rating Organization (NRSRO). KBRA’s mission is to provide transparent ratings, valuable information, and thorough research to market participants. Our widely available research challenges entrenched and conventional thinking, and this approach has resonated powerfully with investors. Today, KBRA is one of the five largest rating agencies globally and the largest rating agency established after the 2008 crisis. KBRA has approximately 450 employees in five offices across the United States, Europe and the UK and has issued more than 56,000 ratings representing \$3 trillion in issuance. KBRA has rated nearly 950 transactions as the sole rating agency, and more than 1,100 transactions where KBRA is one of two rating agencies providing a rating.

I am especially grateful for the subcommittee’s strong bipartisan interest in these issues. This hearing is particularly critical and timely given the impact that S&P’s proposed Insurer Risk-Based Capital Adequacy – Methodology and Assumptions (“S&P’s Proposed Methodology”) has had on the markets. While S&P temporarily withdrew certain sections of this methodology two days before this hearing, it is important to note the proposal caused an immense amount of concern in the markets, and we have seen KBRA-rated transactions put on hold as a direct result of concern about the outcome of S&P’s proposal.¹ Despite the temporary withdrawal of certain features of the S&P Proposed Methodology, KBRA believes it is still crucial to have a robust discussion concerning competition among NRSROs and proposed legislation to level the playing field.

Barriers to Competition in the NRSRO Market

Notwithstanding KBRA’s success over the past 12 years, we still experience barriers to fair competition. It is widely acknowledged that concentration in the credit rating space was a major cause of the 2008 financial crisis, and Congress sought to address that in the Dodd-Frank Act in 2010. KBRA was established in the wake of the financial crisis with a mission to change the credit rating agency status quo, and as a result we are in a unique position to comment on the current state of competition in the market.

¹ S&P, [Request for Comment: Insurer Risk-Based Capital Adequacy–Methodology And Assumptions](#), Dec. 6, 2021.

Not much has changed. The three largest NRSROs, or “the Big Three,” still command approximately 95 percent market share, only slightly down from over 98 percent pre-2008 crisis.² We believe that the continued lack of open competition is *by far* the biggest problem facing the credit rating space today. KBRA has been successful because of our relentless focus on transparent and thorough research and investor feedback – but it has not been easy. There are myriad ways in which the Big Three are still woven into the fabric of our financial system, as noted below. In our view, this entrenchment disadvantages the financial markets, investors, and the public writ large.

- *Investor Guidelines.* As one example, many institutional investors, including public and private pension funds, require the use of one or more of the largest NRSROs *by name* in their investment guidelines. Many of those guidelines were established decades ago, before other rating agencies existed, and this has become a very significant barrier to competition today. KBRA appreciates the success we have had in assisting investors in changing some of these legacy guidelines, but it will take many more years to change the market sufficiently for the benefit of investors. We believe that all investor guidelines across financial markets should permit the use of any duly SEC-registered NRSRO that is licensed to rate the relevant asset class.
- *Government Regulations and References to NRSROs.* During the height of the pandemic, new barriers to competition emerged in the Federal Reserve emergency lending facilities. These facilities initially required the use of a rating by one or more of the three largest incumbent NRSROs because the facilities used the language from the 2008 financial crisis, before KBRA existed. Investors and other market participants were unhappy with the Federal Reserve’s initial position and Congress, including members of this subcommittee, intervened.

As a result, regulators amended the NRSRO requirements with respect to certain facilities, and the House unanimously passed legislation requiring the Federal Reserve and the Treasury to accept securities rated by *any* NRSRO registered with the SEC. But there is more work to do. In our view, consistent with section 939A of the Dodd-Frank Act, all government agencies should be required to remove any references to specific NRSROs in any regulations or guidance and should use their authority to require supervised entities to do the same. The Department of Labor recently finalized the agency’s approach to 939A.³

- *Additional Structural Barriers to Competition.* Another market dynamic that provides S&P with enhanced market power is the fact that certain key indices require that a security be rated by at least one Big Three credit rating agency before being listed. For instance, the S&P Bond Index requires that a bond have a rating by S&P, Moody’s or Fitch to be index eligible.⁴ Similarly, the Bloomberg Fixed Income Index Methodology requires that a bond be rated by two of the Big Three agencies to be index eligible.⁵ Notably, many insurance companies benchmark to the Bloomberg index for investment purposes and thus will not purchase a non-Big Three rated bond.

² Office of Credit Ratings, Securities and Exchange Commission, [Staff Report on Nationally Recognized Statistical Rating Organizations](#), January 2022.

³ [87 CFR § 12985](#) (March 8, 2022).

⁴ S&P, [S&P 500 Bond Index Methodology](#), Oct. 2021.

⁵ Bloomberg, [Bloomberg Fixed Income Index Methodology](#), Aug. 24, 2021.

- *Opening the Path to SEC Registration.* Currently, SEC regulation requires new NRSRO applicants to provide written statements from investors who have used the applicant credit rating agency's credit ratings for at least three years.⁶ This requirement dates back to the Credit Rating Agency Reform Act of 2006. It is already difficult to enter the credit rating agency market *with* SEC registration; we believe that this requirement as it currently stands effectively blocks new entrants. We encourage reconsidering certain registration requirements to allow new competitors to enter the credit rating agency market.

On top of these significant existing systemic barriers to competition, S&P's Proposed Methodology would have further entrenched its position as the most dominant credit rating agency by establishing disparate and arbitrary treatment of non-S&P ratings on bonds across all asset classes held by insurance companies.

S&P's Proposed Methodology and how it Creates Barriers to Competition

Insurance companies are large purchasers of rated debt, and S&P's Proposed Methodology would penalize any S&P-rated insurance company that did not buy S&P-rated debt, to the detriment of insurance companies, the market sectors in which insurance companies invest, and other credit rating agencies.

Why Insurance Companies Purchase Securities. For context, in 2021, US insurance companies invested approximately \$4.9 trillion in bonds alone, which represents an increase of 5.1% compared to 2020.⁷ Insurance companies must maintain large investments of highly rated securities to match their liabilities and meet capital adequacy requirements, or risk-based capital ("RBC"), imposed by insurance regulators. Insurance regulators use RBC requirements to determine the amount of capital an insurer must maintain to support its operations and pay policyholder claims.

An insurance company's credit rating reflects the likelihood that the company will have funds to pay a policyholder's claims, including during economic downturns and catastrophic events that result in large numbers of significant claims. An insurer's credit rating directly affects its ability to expand existing business or obtain new business, to raise capital efficiently and to hedge its financial exposure through reinsurance. Further, an insurer's credit rating is significantly influenced by the risk profile of the bonds and other securities that it holds in its investment portfolio.

S&P's Proposed Methodology. Because of S&P's historical market dominance, the insurance industry has long regarded S&P's capital model as critical to their credit rating and as such, many insurance companies manage their capital to S&P's capital model. S&P's Proposed Methodology represents a significant departure from S&P's current practices by (i) formalizing notching in the insurance company rating sector and (ii) notching down securities not rated by S&P to as low as CCC (the equivalent of unrated securities).

S&P's Proposed Methodology creates a three-tier scale for rating the riskiness of the bonds and loans on an insurance company's balance sheet based on which credit rating agency issued the rating (and

⁶ 15 USC § 78o.

⁷ NAIC, [Capital Markets Special Report, "U.S. Insurance Industry's Cash and Invested Assets Surpass \\$8 Trillion at Year-End 2021"](#), May 4, 2022.

not based on an independent analysis of creditworthiness of the bonds or loans or on the particular insurance company's portfolio performance or track record).⁸

- If bonds or loans are rated by S&P, the rating is taken at **face value**.
- If the bonds or loans are rated by Moody's or Fitch (or both), S&P will notch down the Moody's or Fitch ratings by **one to three notches**, depending on the scenario and asset class.
- If the bonds or loans are rated by non-Big Three agencies, S&P will automatically notch down the ratings to as low as CCC – in some cases that could be up to eighteen notches (or AAA to CCC) – which is the equivalent of a risky “junk”, or near default, investment.

The notching is *solely* based on which credit rating agency issued the rating on the securities, and not on the creditworthiness of the securities themselves. As a result, S&P's treatment “overrules” the credit opinions of all other NRSROs.

S&P's Proposal is not Supported by the Market

S&P's Proposed Methodology has been widely derided by the market writ large for its potential harm to the capital markets, failure to consider available data, and its anti-competitive effect.

Lack of Data. A number of the largest investment banks have publicly released research reports refuting S&P's reported claims that there is not sufficient data to complete a mapping analysis of credit rating agencies other than Moody's and Fitch. In fact, many of these investment banks performed their own analyses based on publicly available data and concluded that there is a high correlation between S&P's ratings and those of other credit rating agencies: “Fitch, Moody's, DBRS and Kroll all have ratings that are highly correlated with S&P ratings.”⁹ This calls into question the decision to notch other credit rating agencies' ratings at all.

Insurance Companies and Industry Groups Object to S&P's Proposal. We are aware that at least eight industry groups and multiple insurance companies have submitted comments to S&P concerning the lack of data supporting S&P's approach, the potential harm to the credit markets and the anti-competitive effect of S&P's proposal. In particular, one securities industry organization cited serious concerns with key elements to the proposal and the considerably adverse ramifications those elements could have on insurance companies, the capital markets, and important sectors of the economy. It also stated that its members unanimously agree that the proposed methodology, in its current form, has embedded fatal flaws.¹⁰ An insurance industry organization stated that S&P's use of a global methodology impairs the RBC formula's ability to assess risk effectively across different jurisdictions and diminishes the methodology's transparency and credibility. It continues to say that specific changes suggested by S&P, as well as their overall approach, may also have unforeseen effects on the U.S. and global insurance markets.¹¹

⁸ See *supra*, note 1.

⁹ Morgan Stanley, “[Analysis of Historical NRSRO Ratings Data](#).” Feb. 2022.

¹⁰ Structured Finance Association, [Response to S&P Global Ratings' Request for Comment: Insurer Risk-Based Capital Adequacy](#), April 29, 2022.

¹¹ American Property Casualty Insurance Association, [Response to S&P Insurer Risk-Based Capital Adequacy—Methodology and Assumptions](#), April 28, 2022.

Government Reaction. Members of this Committee have also sounded the alarm about S&P's Proposed Methodology and its potential effects on the market, and we thank them for this swift action. In addition, at least two attorneys general from Nebraska and Iowa have submitted public comments to S&P concerning the potential anticompetitive effect of the proposal, stating "[w]e are particularly concerned about the effect this may have on the market because of the existing market concentration among the large NRSROs, along with the industry's historic failures to provide accurate risk assessments in the case of Enron and the 2008-2009 financial crisis, which caused significant economic turbulence."¹² The National Association of Insurance Commissioners (NAIC), in a letter signed by NAIC CEO Mike Consedine and leaders from the states of Idaho, Missouri, Connecticut, and North Dakota, sent a letter on behalf of all fifty US state insurance commissioners to Chairwoman Waters and Ranking Member McHenry expressing concern over the S&P proposal. Specifically, NAIC wrote that "...it has been suggested by some that NAIC's concern and workplan in this area is either an implicit or explicit endorsement of S&P's proposal which, in essence, treats the work of its competitors as less rigorous than its own. This is an egregious misrepresentation of our views."¹³

Moreover, on April 29, 2022, the Department of Justice issued a press release which states:

Based on the information provided by S&P, it appears that S&P is proposing to automatically lower its ratings for assets in insurance company investment portfolios rated solely by S&P's competitors. Such changes may affect the incentives of companies to use rating agencies other than S&P or invest in assets rated by agencies other than S&P.

The Antitrust Division suggests that S&P carefully consider whether penalizing insurers that purchase securities rated by S&P's competitors has the potential to raise barriers to entry and expansion by competitors, insulate S&P from competition, or otherwise suppress competition from rival rating agencies. Such actions could raise significant concerns that the Sherman Act has been—or will be—violated and warrant additional scrutiny by the Antitrust Division.¹⁴

Importance of Competition in the NRSRO Market

Mr. Chairman, the potential negative effects of the S&P Proposed Methodology are significant, and bring to light the importance of open competition to investors and the broader economy. Although S&P has publicly withdrawn the sections relating to mapping and notching, it is important to note that S&P's market power is so great that they are able to cause disruption in the market merely with a proposed methodology. KBRA was founded on the premise that open competition protects investors and provides access to ratings to worthy issuers that may be overlooked by the largest incumbent rating agencies. KBRA has discussed this with this subcommittee in the past and it remains true – open and fair competition among NRSROs is the best way to expose investors to a diversity of ideas and information.

¹² Attorneys General of the States of Nebraska and Iowa, [Public Comments from the Attorneys General of Nebraska and Iowa in Response to Standard and Poor's Global Ratings Request for Comment Regarding Insurer Risk Based Capital Adequacy—Methodology and Assumptions](#), April 29, 2022.

¹³ NAIC, [Letter to House Financial Services Committee Re: S&P Global Ratings Request for Comment Regarding Insurer Risk Based Capital Adequacy—Methodology and Assumptions](#), March 9, 2022.

¹⁴ US Department of Justice, [Comments of the Antitrust Division of the United States Department of Justice Re: Insurer Risk-Based Capital Adequacy](#), April 29, 2022.

The more voices that can provide clear, transparent research, the more choices investors have to make well-informed decisions.

Community Banks. One powerful example is in the community bank space. KBRA began researching community banks in 2013. Other rating agencies historically demonstrated a bias based on size of the institution and only rated banks with a certain minimum revenue, while failing to account for other factors such as strength of management. KBRA conducted a study of bank defaults after the 2008 financial crisis and found that community banks performed better than their much larger counterparts, due in large part to the strength of their management and their close connection to their customers. Based on this study, KBRA devised a bank rating methodology that recognized the strength of management which allowed previously unrated smaller banks to be rated. As a result, KBRA has rated over 200 community and regional banks. On the heels of our thorough published research and entry into this market sector, the incumbent rating agencies followed suit and for the first time began rating community banks as well. KBRA's ratings have enabled community banks to access capital they had unfairly struggled to access in the past. The strength of our ratings is demonstrated by the fact that these markets are as liquid as those for the larger banks. Facilitating the creation of liquidity in the community bank market will benefit institutions and consumers alike. When banks do not have access to reasonable and affordable financing options, they are more likely to pass on those costs to customers in the form of higher interest rates and fees, making them less competitive with larger banks. As evidenced by the community bank example, competition among NRSROs can facilitate the creation of efficient capital sources for issuers, and keep costs lower for consumers.

Anti-Competitive Effect of S&P's Proposed Methodology

Mr. Chairman, we cannot speak to S&P's intent in notching in this methodology, but it is clear that S&P's proposal will harm competition among NRSROs, which in turn will harm investors and consumers.

New Barriers to Competition. S&P's Proposed Methodology will create artificial barriers to competition that will solely serve to reinforce S&P's already dominant market position. Insurance companies with an S&P rating are likely to solely invest in S&P-rated bonds and loans to ensure their investment portfolio does not result in a lower S&P rating on the insurance company itself. Additionally, companies issuing bonds and other securities will need to obtain an S&P rating to attract critically important insurance company investors, which, as noted above, need to purchase a large quantity of securities to fulfill their promises to policyholders, match their liabilities, and meet regulatory capital requirements. Moreover, because issuers pay for their financial strength rating and ratings on assets, and only one rating is necessary for state risk-based capital purposes, the S&P methodology will act as a powerful incentive for insurance companies to solely purchase S&P ratings to meet their rating needs. In other words, insurers would be pressured to exclusively purchase S&P-rated investments if this methodology were finalized as proposed, because otherwise they would risk being forced to hold higher levels of capital to preserve their S&P rating, even where assets rated by other NRSROs would be treated as high-quality and satisfactory for state regulatory capital purposes.

S&P Will Gain More Market Share. Another damaging result of S&P's Proposed Methodology will be that S&P will gain – and other credit rating agencies will lose – market share, further damaging the future of competition among NRSROs. Instead of using other NRSROs for ratings that are solely used for RBC purposes, insurance companies will be forced to require issuers to obtain S&P ratings to create the best possible outcome for their own ratings. This means that in those asset classes where insurance companies are key investors, but S&P does not currently provide ratings or is not a leader (e.g., marketplace lending, solar asset-backed securities (ABS) and commercial real estate (CRE)

collateralized loan obligations (CLOs)), issuers will have to obtain S&P ratings to allow the insurance company investors to meet their own requirements. This will allow S&P to rate asset classes in which it has no history or limited experience, force S&P's expansion into those asset classes and sideline those rating agencies with history and experience – none of which serves investors or the market. This gain in market share will create concentration risk in the credit rating agency space – the same risk the Dodd-Frank Act was designed to disarm.

An example of an asset class in which S&P is not currently a leader is conduit commercial mortgage-backed securities (CMBS). S&P was once a market leader in this asset class, but after S&P agreed to a ban on rating conduit CMBS transactions from January 2015 to January 2016 as part of an SEC settlement related to misrepresentations it made with respect to its conduit CMBS methodology application, S&P did not regain the market share it had prior to the ban. It seems an irrational result that under S&P's Proposed Methodology, any conduit CMBS security issued during S&P's 2015 ban from the sector and still held in an insurance company's portfolio would automatically be notched down even though it was *not even possible* for an insurer to invest in an S&P-rated CMBS security during that time due to a regulatory ban.

Mr. Chairman, as I mentioned earlier, we are already seeing the chilling effect on competition among credit rating agencies and have already seen some transactions that have been put on hold pending the outcome of S&P's Proposed Methodology. Indeed, market participants and observers have recognized the likely anti-competitive effects of S&P's Proposed Methodology:

- “It could certainly push someone toward S&P.”¹⁵
- “S&P's new methodology uses higher capital charges for fixed income instruments that it does not rate. . . . Capital treatment is particularly punitive for securities without ratings from S&P, Moody's, and Fitch.”¹⁶
- “It's an overuse of their market power,” [John Huff] said of S&P. “It will have a negative impact on ratings for the Bermuda market without any reasonable justification or market changes. It is clearly anticompetitive.”¹⁷

Policy Ideas to Support Competition

The Dodd-Frank NRSRO Provisions Work Well in Many Regards. Mr. Chairman, in our view, many components of the Dodd-Frank Act NRSRO provisions have been highly successful. The requirement that NRSROs publicly post their methodologies and substantive changes thereto allows investors to familiarize themselves with and scrutinize methodologies in advance of their implementation, and this requirement played a direct role in S&P's withdrawal of changes that would have had a negative effect on the market and NRSRO competition.

¹⁵ Leah Nylen, POLITICO, “S&P Global ‘power grab’ sparks congressional pushback” Feb. 25, 2022, available at: <https://www.politico.com/news/2022/02/25/s-p-insurance-power-grab-sparks-rival-congressional-pushback-00010344>.

¹⁶ Barclays Credit Research, *S&P's Proposed Capital Model Causes a Stir*, Feb. 25, 2022.

¹⁷ THE ROYAL GAZETTE, “Abir: S&P proposals are onerous and disruptive,” April 22, 2022, available at: <https://www.royalgazette.com/re-insurance/business/article/20220422/abir-sp-proposals-are-onerous-and-disruptive/>.

In addition, other provisions in Dodd-Frank regarding NRSROs have served to improve outcomes for investors, including the creation of the Office of Credit Ratings (OCR) at the SEC, the SEC's rules requiring the development of internal controls, and supervision and annual examination. Further, in 2014 the SEC imposed new requirements on NRSROs to establish procedures to protect the integrity of ratings methodologies and implement stricter standards for training and competence of credit analysts. The SEC also required that NRSROs publicly disclose credit rating performance statistics including initial credit ratings and any subsequent changes to those ratings to allow investors to evaluate them for accuracy and compare the performance of ratings across credit ratings agencies.

To provide a specific example of what we believe has worked well, pursuant to the Dodd-Frank Act, in 2014 the SEC issued rules to prevent an NRSRO's sales and marketing considerations from influencing their credit ratings. This division between business development and analytics, one that must be certified by the CEO on an annual basis, has been highly effective in focusing our analysts on producing the highest quality, transparent and thorough research for investors.

Strengthening Competition. As I noted earlier, the lack of competition is the single largest problem in the credit rating space today. We believe there is room to strengthen federal law to help bolster competition and increase disclosure. We support the notching amendments being discussed here today that would prohibit actions taken by credit rating agencies that have an anti-competitive effect and to prohibit notching, while maintaining credit rating agencies' ability to determine its rating methodologies. We believe it is of the utmost importance for a credit rating agency to have the flexibility and freedom to create its own methodologies, but such methodologies must not have the effect of prohibiting competition. We also support efforts to encourage the SEC to undertake a mapping exercise – similar to that performed by Canadian and European regulators – to publicly disclose the correlation of ratings issued by credit rating agencies so that all market participants can compare the performance of an NRSRO's credit ratings for themselves. We believe increased availability of information can only be a positive for the market and the investing public.

Commercial Credit Rating Reform Act. I would also like to provide some input on the proposed Commercial Credit Rating Reform Act ("CCRRA"), which is being discussed today. We support efforts to improve competition and are grateful for your ongoing attention to that issue. However, we do have some concerns regarding potential unintended consequences of this legislation. While a government assignment of ratings would by its nature increase the market share of non-incumbent NRSROs, it could also discourage thorough research. If any NRSRO were assured of receiving steady, virtually guaranteed business via government panel rotation, this could act as a disincentive for some NRSROs to devote the resources necessary to produce in-depth analysis and solid research. That would ultimately be detrimental to investors, who would suffer from the lack of transparent and thorough information abundantly available to the market today from rating agencies like KBRA. *In our view, the Big Three enjoy virtually guaranteed business today by virtue of systemic barriers to competition and self-reinforcing market dominance. Our experience of NRSROs having virtually guaranteed business for any reason is that it can result in disincentives to produce high-quality research.*

Government assignment of ratings pursuant to the CCRRA would also restrict investor choice. It is our experience that investors often drive issuers to choose different NRSROs in various asset classes because of the strength of an NRSRO's experience and research in that particular asset class. If a government panel selected an NRSRO that did not meet investors' needs, investors would potentially not buy the rated securities and the transaction could flounder or fail. This could also impair access to capital for market participants and have a trickle-down effect for consumers through increased costs.

Our strong conviction is that removing institutional barriers to competition and allowing open competition to flourish is a better way, and indeed, the best way, to protect investors. We greatly appreciate the concerns animating this proposal and would welcome the opportunity to provide input throughout the legislative process.

NRSRO Exposure in Russia and Belarus. Mr. Chairman, we understand that some committee members may be concerned that medium- and smaller-sized NRSROs have not made clear their exposure to Russia or Belarus. We respect the work of this Committee on this issue, and while I cannot speak for the other medium or smaller NRSROs, I can assure you that KBRA has no outstanding Russian or Belarusian ratings, and any outstanding ratings with underlying assets that have exposure to those countries are being closely monitored. In addition, on March 22, 2022, KBRA announced a ban on registered website users located in Russia. We would welcome the opportunity to engage on this issue with members of your committee if additional information would be helpful.

Other Policy Proposals to Support Competition Among NRSROs. Mr. Chairman, there is more work to do in requiring government and private market participants to support open competition among NRSROs, and we greatly appreciate your leadership in this area. We strongly support the legislation regarding the Federal Reserve emergency facilities, introduced by Reps. Madeleine Dean (D-PA) and Andy Barr (R-KY), that passed the House unanimously last year, and thank the members of this Committee for their support for this legislation. We strongly support broadening the emergency facilities legislation to prevent other federal government agencies from requiring ratings by specific NRSROs, as is currently the case, for example, with certain Federal Home Loan Banks and certain Freddie Mac requirements. We would welcome the opportunity to engage with Committee members regarding the specifics of governmental barriers to competition.

Liability Proposal. We have also read the proposal being discussed today regarding liability for NRSROs. We believe that the current SEC regulatory oversight provides the appropriate level of liability for NRSROs. Since the enactment of the Dodd-Frank Act, the SEC has had the ability to – and has exercised – its ability to enforce existing federal regulation. The SEC has multiple tools in their enforcement arsenal; not only can the agency enforce the current credit rating agency regulation but can also seek to hold NRSROs liable pursuant to the anti-fraud and negligence provisions of the Securities Exchange Act of 1934 and the Securities Act of 1933, respectively. Moreover, as we saw from the private litigation post-financial crisis, investors have myriad avenues of recourse against NRSROs in the courts.

We do not believe that additional liability is necessary and could have a chilling effect on the diversity of views provided by NRSROs, which would ultimately harm the market. First, we believe that holding NRSROs liable pursuant to Section 11 of the Securities Act of 1933 is in direct conflict with how the market already functions as a result of the changes provided by the Dodd-Frank Act. Because credit ratings are based entirely on the information provided to an NRSRO by or on behalf of an issuer, NRSROs generally require issuers or other parties who engage with NRSROs to represent and warrant the accuracy of the information they are providing for the ratings being conducted. This means that the information the NRSRO receives should be exactly the same as the information being provided in the registration statement that is the subject of Section 11. As such, NRSROs are in the same position as the investors receiving the information from the transaction parties and should be treated as such.

Second, pursuant to Rule 17g-5(c)(5), NRSROs are prohibited from making recommendations about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security. As a result, NRSROs are required to take the information as it is provided to them to conduct the rating and

do not function as due-diligence providers with respect to such information. Those who have the expertise to structure transactions do so, but NRSROs are not those experts; they rate what those with the expertise structure and present to them.

Third, additional liability would ultimately narrow the NRSRO market and make ratings less useful to investors. To avoid liability, NRSROs would likely converge in a single, narrow view. This would eliminate the diversity of views NRSROs currently provide and leave investors with diminished choice. It would also naturally limit the amount of research and transparency NRSROs currently provide, leaving investors with less thorough information with which to make their investment decisions.

Mr. Chairman, in short, we are of the opinion that the current regulatory and legal frameworks provide the tools for holding NRSROs responsible, and we believe the SEC and the investing public make good use of them. We look forward to continued engagement on this issue with members of this subcommittee.

Standardization Proposal. We have also read the proposed Credit Rating Standardization Bill being discussed here today. We appreciate the opportunity to provide input but do have concerns that the legislation in its current form could unintentionally reduce the quantity and quality of information available to investors in making their investment decisions.

The great benefit of open competition in the credit rating agency market is that it allows more independent entities to conduct research and provide their views on credit and related information to the investing public. Credit rating agencies spend a great deal of time and effort conducting research on historical performance in various markets to develop their views on rating definitions. Each rating category has a specific definition as it is defined by that credit rating agency, based on the research conducted. Over time, credit rating agencies monitor rating performance of their own ratings and make adjustments to their methodologies to align with their rating definitions and rating scales. I believe that rating definitions and rating scales must be left to credit rating agencies to determine. It is our view that government involvement in the setting of rating categories and, as a result, rating definitions, would be akin to government interference in the determination of credit rating methodologies.

While we have concerns with this legislation in its current form, KBRA would support legislation requiring more transparency and easily accessible and comparable disclosure relating to how each credit rating agency has set its rating definitions and rating categories so that users of credit ratings can more easily compare those ratings.

Conclusion

Mr. Chairman, I am confident in KBRA's mission, our team, and our research and ratings. KBRA's entrance into this marketplace has enhanced the quality of research, opened markets, and improved outcomes for investors. I believe this is what the Dodd-Frank Act intended to do, and I encourage the development of stronger guardrails to enhance competition. I thank the subcommittee for the opportunity to testify today, and I look forward to your questions.