

MEMO# 19449

December 5, 2005

INSTITUTE PRESIDENT TESTIFIES AT HOUSE COMMITTEE ON FINANCIAL SERVICES HEARING ON CREDIT RATING AGENCIES

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19449] December 5, 2005 TO: BOARD OF GOVERNORS No. 61-05 FEDERAL LEGISLATION MEMBERS No. 5-05 SEC RULES MEMBERS No. 123-05 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 18-05 FIXED-INCOME ADVISORY COMMITTEE No. 21-05 INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 3-05 RE: INSTITUTE PRESIDENT TESTIFIES AT HOUSE COMMITTEE ON FINANCIAL SERVICES HEARING ON CREDIT RATING AGENCIES On November 29, Institute President Paul Schott Stevens testified before the House Committee on Financial Services at a field hearing on credit rating agencies entitled the "Credit Rating Agency Duopoly Relief Act of 2005." The topic of the hearing was H.R. 2990, introduced earlier this year by Rep. Michael Fitzpatrick (R-PA) to implement certain reforms in the credit rating industry. Mr. Stevens' testimony is summarized below.* Mr. Stevens discussed the variety of ways that mutual funds utilize credit ratings, most significantly, the considerable influence of credit ratings on the \$2 trillion invested in money market mutual funds. He noted that money market funds are limited in the types of securities in which they can invest by Rule 2a-7 of the Investment Company Act of 1940, which employs credit ratings as an integral part of these limitations. Given the importance of reliable and credible credit ratings to the mutual fund industry, Mr. Stevens stated that maintaining the integrity and quality of the credit ratings process is essential to sustaining investor confidence and to promoting the proper functioning of the U.S. capital markets. To promote the integrity and quality of the credit ratings process, Mr. Stevens recommended that several steps be taken. * The full text of Mr. Stevens' testimony can be found on the Institute's website at

http://www.ici.org/home/05_house_nrsro_tmny.html#TopOfPage. Also testifying at the hearing were: Glenn Reynolds, Chief Executive Officer, CreditSights, Inc.; Richard Y. Roberts, Partner, Thelen Reid & Priest LLP, on behalf of Rapid Ratings Pty Ltd.; Jonathan R. Macey, Sam Harris Professor of Corporate Law, Corporate Finance, and Securities Law, Yale Law School; and Sean Egan, Managing Director, Egan-Jones Ratings Co. The written testimony of these witnesses can be found on the Committee on Financial Services' website at <http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=432>. 2 • First, Mr. Stevens called for the introduction of competition in the ratings industry through the reform of the SEC's current process for the designation of NRSROs. Specifically, he recommended that the current "national recognition" standard be replaced by a

mandatory, expedited SEC registration requirement, as proposed in H.R. 2990. Mr. Stevens stated that robust competition for the credit ratings industry is the best way to promote the continued reliability of their ratings. • Second, Mr. Stevens called for increased regulatory oversight by the SEC of NRSROs through a combination of periodic filings with the SEC and appropriate inspection by the SEC, coupled with adequate enforcement powers. He stated that while the implementation of a new NRSRO designation process would undoubtedly spur competition, at the same time, to ensure the integrity and quality of credit ratings, there must be effective regulatory oversight of NRSROs after their initial designation. • Third, Mr. Stevens called for regular and timely disclosure of information about NRSROs to investors. He stated that public disclosure of this information would allow investors a continuous opportunity to evaluate an NRSRO's independence and objectivity, capability and operation, and would serve as an effective additional mechanism for maintaining the integrity and quality of credit ratings. • Finally, Mr. Stevens called for some accountability on the part of NRSROs for their ratings in order to provide them with incentives to analyze information critically and to challenge an issuer's representations. He said that any reforms to the credit ratings process should, at a minimum, make NRSROs accountable for ratings issued in contravention of their disclosed procedures and standards. Ari Burstein Associate Counsel

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.