Statement of

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to

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Committee on Financial Services
Subcommittee on Capital Markets, Insurance
and Government Sponsored Enterprises

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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 ("SEC") in 1975.

Since 1989 when Fitch was recapitalized by a new management team, Fitch has experienced dramatic growth. Throughout the 1990's, Fitch especially grew in the new area of structured finance, by providing investors original research, clear explanations of complex credits, and more rigorous surveillance than the other rating agencies.

In 1997, Fitch merged with IBCA Limited, another NRSRO headquartered in London, significantly increasing Fitch's worldwide presence and coverage in banking, financial institutions and sovereigns. Through the merger with IBCA, Fitch became owned by Fimalac S.A., a holding company which acquired IBCA in 1992. The merger of Fitch and IBCA represented the first step in our plan to respond to investors' need 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 of Duff & Phelps Credit Rating Co., an NRSRO headquartered in Chicago, in April, 2000 followed by the acquisition later that year of the rating business of Thomson BankWatch. These acquisitions strengthened our coverage in the corporate, financial institution, insurance and structured finance sectors, as well as adding a significant number of international offices and affiliates.

As a result of Fitch's growth and acquisitions, it today has approximately 1,250 employees, including over 700 analysts, in over 40 offices and affiliates worldwide. Fitch currently covers 2,300 banks and financial institutions, 1,000 corporations, 70 sovereigns and 26,000 municipal offerings in the United States. In addition, we cover over 7,000 issues in structured finance, which remains our traditional strength.

Fitch is in the business of publishing research and independent ratings and credit analysis of securities issued around the world. A rating is our published opinion as to the creditworthiness of a security distilled in a simple, easy to use grading system ("AAA" to "DDD"). Explanatory information is typically provided with each rating.

Rating agencies gather and analyze a variety of financial, industry, market and economic information, synthesize that information and publish independent, credible assessments of the creditworthiness of securities and issuers thereby providing a convenient way for investors to judge the credit quality of various alternative investment options. Rating agencies also publish considerable independent research on credit markets, industry trends and economic issues of general interest to the investing public.

By focusing on credit analysis and research, rating agencies provide independent, credible and professional analysis for investors more efficiently than the investors could perform that analysis themselves.

Currently, we have over 3,200 institutional investors, financial institutions and government agencies subscribing to our research and ratings and thousands of investors and other interested parties that access our research and ratings through our free website and other published sources and wire services such as Bloomberg, Business Wire, Dow Jones, Reuters and *The Wall Street Journal*.

Ratings are used by a diverse mix of both short-term and long-term investors as a common benchmark to grade the credit risk of various securities.

In addition to their ease of use, efficiency and wide spread availability, we believe that credit ratings are most useful to investors because they allow for reliable comparisons of credit risk across diverse investment opportunities.

Credit ratings accurately assess credit risk in the overwhelming majority of cases. Credit ratings have proven to be a reliable indicator for assessing the likelihood that a security will default. Fitch's most recent corporate bond and structured finance default studies are summarized below.

Fitch Average Annual Default Rates

	Corporate Finance* 1990 - 2001	Structured Finance** 1991 - 2001
AAA	0.00%	0.00%
AA	0.00%	0.01%
A	0.04%	0.01%
BBB	0.27%	0.11%
BB	1.55%	0.31%
B	1.68%	1.24%
CCC - C	21.97%	20.88%
Investment Grade	0.09%	0.02%
Non Investment Grade	3.01%	1.27%

* Based on Fitch-rated global corporate debt issuers.
** Based on Fitch-rated U.S. structured finance bonds.

The performance of ratings by the three major rating agencies is quite similar. We believe this similarity results from the common reliance on fundamental credit analysis and the similar methodology and criteria supporting ratings.

Through the years, NRSRO ratings also have been increasingly used in safety and soundness and eligible investment regulations for banks, insurance companies and other financial institutions. While the use of ratings in regulations has not been without controversy, we believe that regulators rely on ratings for the same reason that investors do: ease of use, wide spread availability and proven performance over time.

Although other methods can be used to assess the creditworthiness of a security, such as the use of yield spreads and price volatility, we believe that such methods, while valuable, lack the simplicity, stability and track record of performance to supplant ratings as the preferred method used by investors to assess creditworthiness.

However, we also believe that the market is the best judge of the value of ratings. We believe that if ratings begin to disappoint investors they will stop using them as a tool to assess credit risk and the ensuing market demand for a better way to access credit risk will rapidly facilitate the development of new tools to replace ratings and rating agencies.

The SEC Report

Beginning last spring, the SEC began a thorough study of rating agencies that included informal discussions with Fitch and the other rating agencies, a formal examination of our practices and procedures and two full days of public hearings held in November in which we participated. In July, Congress passed the Sarbanes-Oxley Act of 2002 requiring that the SEC produce a report on the role and function of credit rating agencies in the operation of the securities markets. All of the work of the SEC culminated in the issuance of its Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Market (the "Report") as required by the Sarbanes-Oxley Act in January of this year.

The Report stated that the SEC plans to publish a concept release eliciting public comments on the following issues: information flow, potential conflicts of interest, competition and barriers to entry and ongoing oversight. We expect the concept release to be published in the very near future.

We believe the SEC review of the rating agencies has been a constructive and thorough process. As a result of its review, the SEC recommended that we consider certain changes to our policies and procedures including enhancements to our document retention and securities trading and compliance policies that we voluntarily agreed to institute in this coming year.

Set forth below is a summary of our views on the issues we understand the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises intends to explore at its hearing entitled *Rating the Rating Agencies: the State of Transparency and Competition* to be held on April 2, 2003.

Conflicts of Interest

Fees. We do not believe that the fact that the issuer pays a fee to Fitch creates an actual conflict of interest, i.e., a conflict that impairs the objectivity of Fitch's judgment about creditworthiness reflected in Fitch ratings. Rather, for the reasons stated below and based on our experience, it is more appropriately classified as a potential conflict of interest, i.e., something that should be disclosed and managed to assure that it does not become an actual conflict.

Charging a fee to the issuer for the analysis done in connection with a rating dates back to the late 1960s. It is widely known by investors.

By way of context**,** our revenue comes from two principal sources: the sale of subscriptions for our research and fees paid by issuers for the analysis we conduct with respect to ratings**.** In this we are similar to other members of the media which derive revenue from subscribers and advertisers that include companies that they cover. Like other journalists, we emphasize independence and objectivity because our independent, unbiased coverage of the companies and securities we rate is important to our research subscribers and the marketplace in general.

Fitch goes to great efforts to assure that our receipt of fees from issuers does not affect our editorial independence. We have a separate sales and marketing team that works independently of the analysts that cover the issuers. In corporate finance ratings, analysts generally are not involved in fee discussions. Although structured finance analysts may be involved in fee discussions, they are typically senior analysts who understand the need to manage the potential conflict of interest.

We also manage the potential conflict through our compensation philosophy. The revenue Fitch receives from issuers covered by an analyst is not a factor in that analyst's compensation. Instead, an analyst's performance, such as the quality and timeliness of research, and Fitch's overall financial performance determine an analyst's compensation. Similarly, an analyst's performance relative to his or her peers and the overall profitability of Fitch determine an analyst's bonus. The financial performance of analysts' sectors or groups do not factor into their bonuses.

Fitch does not have an advisory relationship with the companies it rates. It always maintains full independence. Unlike an investment bank, our fees are not based on the success of a bond issue or tied to the level of the rating issued. The fee charged an issuer does not go up or down depending on the ratings assigned or the successful completion of a bond offering.

Our fee is determined in advance of the determination of the rating and we do not charge a fee for a rating unless the issuer agrees in advance to pay the fee. While we do assign ratings on an unsolicited basis, we do not send bills for them. Any issuer may terminate its fee arrangement with Fitch without fear that its rating will be lowered, although we do reserve the right to withdraw a rating for which we are not paid if there is insufficient investor interest in the rating to justify continuing effort to maintain it.

Ancillary Businesses. Concern has also been raised about the potential conflicts of interest that may arise when rating agencies develop ancillary fee-based businesses. Over the years, revenue derived by Fitch from non-rating sources, including consulting and advisory services, has been minimal. Historically, the bulk of such services related to providing customized ratings, performance, or scoring measures and were usually provided to subscribers of our subscription products, which were not necessarily entities that we rate.

In the fourth quarter of 2001, Fitch's parent company established Fitch Risk Management, Inc. ("FRM"), a newly formed company offering risk management services, databases and credit models to help financial institutions and other companies manage both credit and operational risk. Fitch Ratings and FRM are subject to a "fire wall" policy and FRM has its own employees, offices and marketing staff.

Concerns also have been expressed that additional conflicts of interest issues are posed by rating agencies providing so-called ratings advisory services. In the course of the SEC's review of Fitch, the SEC also expressed their concern to us about conflicts arising from rating advisory services. Although Fitch only recently introduced our ratings assessment service in May 2002 and performed only three assessments, in order to address the concerns raised about this service, we have decided to stop accepting new assessment assignments from United States issuers currently rated by Fitch where members of the rating committee will be involved in conducting the assessment. We are currently evaluating whether we will continue the service using analysts that are not part of the rating committee or discontinue the separate fee service.

Competition and Barriers to Entry

Fitch believes that our emergence as a global, full service rating agency capable of competing against Moody's and S&P across all products and market segments has created meaningful competition in the ratings market for the first time in years. Fitch's challenge to the Moody's/S&P monopoly has enhanced innovation, forced transparency in the rating process, improved service to investors and created much needed price competition.

Academic research confirms our belief that innovations in the ratings industry have often "been initiated by the smaller rating firms [Fitch and its legacy firms], with the larger two [Moody's and S&P] then following."[1] At Fitch, we are particularly proud of the work that we have done in the development of innovative methodologies to analyze new structured finance securities. These innovations in the securities markets have had substantial economic benefits. For instance, academic research has found that securitization has had a positive impact on both the availability and cost of credit to households and businesses.[2]

Fitch firmly believes in the power of competition. We also believe that there is always a demand for insightful, independent credit research. The NRSRO system is designed, appropriately in our view, to assure that recognized organizations possess the competence to develop accurate and reliable ratings and protect against the establishment of rating organizations that would ignore their rating process to issue investment grade ratings to low quality securities as convenient. Without a system to recognize rating organizations for their integrity, many important capital adequacy and eligible investment rules used in financial institution regulation would be ineffective.

We believe that the SEC should formalize the process by which a rating organization is recognized. The criteria for recognition should include an evaluation of the organization's resources and policies to avoid conflicts of interest, use of the organization's ratings by market participants and studies of the performance of the ratings over time. We believe these are the reasons that market participants widely use NRSRO ratings, whether or not they are subject to regulations that refer to ratings. We also believe that the SEC should consider continuing the practice of limited recognition that acknowledges the special expertise of smaller organizations in selected areas of specialty such as the prior recognition of IBCA and BankWatch for their expertise in rating banking and financial institutions.

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[1] Lawrence J. White, *The Credit Rating Industry: An Industrial Organization Analysis,* June 2001 (paper presented at the conference on "Rating Agencies in the Global Financial System", presented at the Stern School of Business, New York University, June 1, 2001.

[2] Mark M. Zandi, *The Securitization of America,* Regional Financial Review, February 1998; Ali Anari, Donald R. Fraser and James W. Kolari, *The Effects of Securitization on Mortgage Market Yields: A Cointegration Analysis,* Real Estate Economics, 1998.

Transparency

We believe quite strongly that the process and procedure that rating agencies use should be transparent. Accordingly, at Fitch, there are hundreds of criteria reports published highlighting the methodology we use to rate various types of entities and securities, together with detailed sector analysis on a broad array of sectors, companies, and issues, all available free on our web site (www.fitchratings.com). Fitch has also been a leader in publishing so-called presale reports in the areas of structured finance, global power, project finance and public finance where our published analysis of various transactions of interest to the market is made available free of charge on our web site prior to the pricing of the transaction. In addition, Fitch makes available free of charge on our web site all of our outstanding ratings. Announcements of ratings actions are also distributed through a variety of wire services as mentioned above.

However, certain of our publications and data are only available to our paid subscribers. We commit extensive time and resources to produce our publications and data and we believe they are valuable to anyone interested in objective credit analysis. In this practice we are no different than other members of the financial media, such as Bloomberg, Dow Jones, Thomson Financial and others, that charge subscribers for access to their publications and data services.

While we believe that for the most part credit rating agencies have adequate access to the information they need to form an independent and objective opinion about the creditworthiness of an issuer, improved disclosure by issuers would be welcomed by Fitch. As we found in our recently published study of the use of credit derivatives in the global market[3], financial reporting and disclosure with respect to areas such as credit derivatives, off-balance sheet financing and other forms of contingencies vary greatly by sector and comparability is further obscured by differences in international reporting and accounting standards.

As the SEC noted in their Report, nonpublic information is provided to rating agencies as part of the rating process. The nature and level of nonpublic information provided to Fitch varies widely by company, industry and country. Nonpublic information frequently includes budgets and forecasts, as well as advance notification of major corporate events such as a merger. Nonpublic information may also include more detailed financial reporting.

While access to nonpublic information and senior levels of management at an issuer is beneficial, an objective opinion about the creditworthiness of an issuer can be formed based solely on public information in many jurisdictions. Typically, it is not the value of any particular piece of nonpublic information that is important to the rating process, but that access to such information and senior management can assist us in forming a qualitative judgment about a company's management and prospects.

It is also important that rating agencies not be inhibited in requesting information and thereafter subjecting that information to vigorous internal analysis and discussion. In that connection it is critical that the courts afford shield law and journalist privilege protection to

[3] Fitch Ratings Special Report, *Global Credit Derivatives: Risk Management or Risk?*, March 10, 2003 available at www.fitchratings.com.

rating agencies so that rating agencies are not unduly burdened by third-party discovery and the confidentiality of their deliberative processes are respected.

Another factor critical to the adequate flow of information to and from the rating agencies is the understanding that information can be provided to a rating agency without necessitating an intrusive and expensive verification process that would largely if not entirely duplicate the work of other professionals in the issuance of securities. Thus, as noted by the SEC Report, rating agencies do not perform due diligence or conduct audits and assume the accuracy of the information that is provided to them by issuers and their advisors. Since rating agencies are part of the financial media, we believe that our ability to operate on this assumption, and to exercise discretion in deciding how to perform our analysis and what to publish, is protected by the First Amendment.