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Thank you Chairman Shelby and Ranking Member Sarbanes. My name is Damon Silvers, and I am Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations. The AFL-CIO appreciates the opportunity to discuss the role credit rating agencies play in the debt markets from the perspective of America's working families who are looking to those markets to help fund their retirement, and their childrens' education..

Union sponsored benefit funds have over $400 billion in assets, and union members participate in benefit funds with over $5 trillion in assets. Most defined benefit funds have between 40% and 60% of their assets invested in fixed income investments. Individual union members, if properly advised, will shift the majority of their personal retirement savings into fixed income instruments as they approach retirement age, or will buy annuities from insurance companies rated by the principal credit rating agencies.

Union members' pension funds suffered substantial losses in both Enron and Worldcom bonds when those companies collapsed. Our funds bought those bonds with investment grade coupons relying upon the investment grade ratings they received from the rating agencies. We estimate the total losses to union members' funds from those two companies alone exceeded $35 billion.

Credit rating agencies are a vital part of the functioning of our capital markets. As one Moody's spokesperson has said, "our ratings are essentially a public good." The public good is the provision of reliable, easily analyzed credit quality data to all credit market investors that enable investors to quickly and efficiently make investment decisions without each investor having to determine for themselves the degree of risk involved in a given financial instrument. We believe the existence of credible rating agencies substantially contributes to the lower cost of debt financing compared to equity financing, with positive results for investors, entrepreneurs and workers.

However, public goods are inherently delicate things—if not properly cared for they will vanish under the pressure of self-interested behavior by either their providers or their consumers. If credit agencies behave in a way that casts doubt on the legitimacy of their ratings, the public good of cheap, reliable and uniform data will be in jeopardy.

Credit rating agencies and their critics each have their case studies which either make the credit agencies into heroes or villains. We are less interested in this blame game and more interested in whether there are structural problems with the credit rating system. We begin by recognizing that the credit rating business is an effective duopoly, with the notable exception of the role A.M. Best plays in insurance markets. The Congressional

Research Service estimates Moody's and Standard & Poor together account for 80% of the market.

Many have expressed concern about the level of concentration in the business of auditing public companies' financial statements. Obviously, the degree of concentration in the credit rating business is substantially greater—with two dominant firms and one subordinate firm, compared to four comparably sized major public audit firms and a substantial number of minor ones.

While there are benefits to having a limited number of well-regarded credit rating firms, the current degree of concentration appears excessive. Greater competition however is unlikely to be a sufficient solution to the structural problems with the credit rating business. This is both because the scale and prominence of the existing firms are a formidable barrier to entry and because the real customers are not doing the buying—and it is hard to see how they could without substantially detracting from the liquidity of the credit markets. In this respect as in many others the credit rating business has similarities to the business of public company auditing.

If greater competition is unlikely to be a sufficient solution, then there must be additional sources of accountability. In this respect, credit rating agencies are not all that different than other quasi private entities that play important roles in our capital markets. These entities, the public company audit firms and the self-regulatory organizations, have suffered through significant crises of public confidence since 2001.

There are principles which the problems with financial market gatekeepers have brought to light. First, if there are institutions that are monopolistic and operate in markets where there are significant principal-agent issues, like auditors and credit rating agencies, there will be systematic abuses if there is not government regulation. We have seen in both the Washington Post's coverage of the rating agencies and in the Securities and Exchange Commission's examination of the same allegations of exactly the sort of abuse one would expect to see—alleged differential treatment of firms depending on whether they paid rating agency fees, agencies engaging in consulting businesses that parallel their core ratings businesses, and lax treatment of major issuers like Enron, with devastating consequences.

Second, the regulation that is necessary must focus on three areas—monitoring the seriousness of agency reviews of issuers, preventing abusive business practices like coercing payments through bad ratings, and putting an end to conflicts of interest that lead rating agencies to become too cozy with the companies they rate. This is analogous to the bar on most auditor consulting services contained within the Sarbanes-Oxley Act and expanded on by the PCAOB.

While it is true that credit rating agencies, like audit firms, could make more money by selling consulting services to credit issuers, such conduct is really incompatible with the quasi-public mission they have been entrusted with, and the effective monopoly they have been granted.

We find the need for regulation particularly compelling in light of the existence of the Nationally Recognized Statistical Ratings Organization ("NRSRO") concept in our securities laws. Currently we have essentially a federally protected duopoly whose participants are unregulated. That situation has and will continue to lead to abuses.

The NRSRO concept is helpful in dealing with information costs to investors, government agencies, and a wide variety of financial market actors. Replacing it with a mere registration process without substantive oversight, as some have suggested, will be harmful to investors and the ultimately to the functioning of our credit markets. However, the NRSRO system should be more transparent and open— so that firms that wish to become NRSRO's know what that entails and so that existing NRSRO's can be held accountable to clear standards.

For these reasons we would favor the regulation of the ratings agencies either directly by the Securities and Exchange Commission or by a PCAOB-like body, with the powers to set specific criteria for being recognized as a NRSRO, oversee agency practices, set positive standards and proscribe abusive practices. These were the recommendations of the Senate Committee on Governmental Affairs October, 2002 report following the collapse of Enron. The SEC in its June, 2003 concept release asked for comment on these concepts as well, but the Commission has taken no further action.

This Committee can be very proud of its work in crafting the Sarbanes-Oxley Act of 2002. That Act contains within it the principles that should be applied to the credit rating agencies—real independent oversight, and an end to conflicts of interest. Credit rating agency regulation is part of the unfinished agenda of corporate reform—like the reform of executive compensation that the SEC is now attempting, and the need to reform public company board elections that remains unaddressed. The AFL-CIO commends this Committee for taking up this issue and hopes that this unfinished agenda item can be finished. We appreciate the opportunity to appear before the Committee and look forward to working with you as you move forward.