COMPANHIA PORTUGUESA
DE RATING, S.A.

Ref.: Consultation Paper

Guidelines and Recommendations on the Scope of the CRA Regulation

On the mentioned public consultation Companhia Portuguesa de Rating, S.A. (CPR) wishes to comment on the following (following the numbers of the points and questions on the text):

Obligation to register

Q1. Do you agree with the approach set out above on the obligation to register?

Yes.

Q2. What may be alternative/additional criteria to require registration and certification?

No comment.

Other: there is clearly a typo error in paragraph 28 of the Consultation Paper: it should read "Annex III part I.54" instead of "Annex III.54".

Credit rating activities and exemptions from registration

Practical example given in 3) of paragraph 34

The practical example given in 3) of paragraph 34 is very dangerous, as it is considering automatic models that incorporate qualitative inputs transformed into quantitative inputs suitable to be processed by the algorithms in econometric models as ratings under the CRA Regulation.

CRA Regulation explicit states in its article 3 (1)(o) that "credit rating activities means data and information analysis and evaluation, approval, issuing and review of credit ratings" and in its article 8 (2) that credit ratings must be "based on a thorough analysis of all information that is available (…) and that is relevant to the analysis". Neither the "analysis", the "evaluation", the "approval" or the "thorough analysis of all information that is available (…) and that is relevant to the analysis" are included in the mentioned practical example. **As such, it cannot be considered a rating under CRA Regulation.**

To help understand this issue, the mentioned practical example would include banking internal rating models' outputs, which would begin being considered as (external) ratings under CRA Regulation if banks decided to publicly distribute those (improved) scorings!

Automatic models, even if including qualitative inputs will never be able to detect big point in time risks, by definition not includable in a model, and only detectable by "analysis", "evaluation" and

qualitative judgment ("approval") made "thorough analysis of all information that is available (…) and that is relevant to the analysis" by a rating panel, as established in CRA Regulation.

Conclusion: for all of the above, the mentioned example should be deleted, as it is completely against the letter and the spirit of CRA Regulation, or (as a second option) it should be considered as a scoring example.

This is also reinforced by paragraph 35 of the Consultation Paper, that states that "Credit ratings, as defined in the CRA Regulation, should include not just quantitative analysis but also sufficient qualitative analysis, according to the rating methodology established by the credit rating agency. A measure of creditworthiness derived from summarising and expressing data based only on a pre-set statistical system or model, without any additional substantial rating-specific analytical input from a rating analyst, should not be considered as a credit rating." (underlines added)

Q3. Do you agree with the explanation of credit ratings provided in this document?

and

Q4. Do you believe that the intervention of rating analysts in the assessment of the relevant information is the key element to distinguish credit ratings from credit scorings?

The "sufficient qualitative analysis" and "substantial rating-specific analytical input" should be more precisely defined in the Proposed Guideline of paragraph 35 of the Consultation Paper.

Is it sufficient to ponder 30% the qualitative analysis in a rating to consider this as "sufficient qualitative analysis" and "substantial rating-specific analytical input" (as Scope is doing: please refer to Scope's rating report on the French Groupe Capelli SA)? Or is this just a disguised scoring (70% quantitative analysis)?

CPR suggests to define "sufficient qualitative analysis" and "substantial rating-specific analytical input" as "most of the analysis, involving analysis, evaluation and approval by a group of persons, based on a thorough analysis of all information that is available and that is relevant to the analysis" (based on articles 3 (1)(o) and 8 (2) of the CRA Regulation), as the intervention of rating analysts in the assessment of the relevant information is indeed the key element to distinguish credit ratings from credit scorings, and it is very dangerous for the stability and transparency of the market and for the information and protection of investors to have scorings being used as ratings.

Private ratings

Paragraph 38 of the Consultation Paper allows the person that ordered the private rating "to share the rating with a limited number of third parties and on a strictly confidential basis to ensure that the private rating is not disclosed further".

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Paragraph 39 of the Consultation Paper states that "The agency that issues a private rating should inform the recipient of the restricted private use he is only allowed to make of the rating, that he may only transmit the rating to a limited number of third parties which should be bound to strict confidentiality either by contractual obligations or by the relevant national law and that the private rating cannot be used for regulatory purposes" and the Proposed Guideline in paragraph 42 states that "credit rating agencies should ensure that the agreements for the issuance of private ratings cover the duty of confidentiality and limitations on the distribution of the ratings. In issuing private ratings credit rating agencies should inquire whether the person who placed the order, as recipient of the private rating, has any intention to use the rating in a way that would bring it into the public domain or to use it for regulatory purposes. Where the credit rating agencies can reasonably conclude that a private rating is to be disclosed to the public, it shall refrain from issuing that rating". (underlines added)

Q5. Do you agree with the explanation of private ratings provided?

Yes, although it I almost impossible for a CRA to "reasonably conclude that a private rating is to be disclosed to the public" to "refrain from issuing that rating". It would probably be a better solution to ask CRA's to try to guarantee this in the contract with the person who placed the order and, if that person does not comply with that clause, abstain in the future to have him as a counterparty in a contract, refraining, than, from issuing that rating.

Other: there is clearly a typo error in paragraph 40 of the Consultation Paper: it should read "in" instead of "outside".

Establishment of branches outside the EU by registered CRAs

Q6. Do you agree with the approach taken in the text above regarding the establishment of branches of registered credit rating agencies outside the Union?

Yes.

Q7. Do you agree that credit rating agencies should demonstrate that there is an objective reason to conduct certain credit rating activities in branches established outside the Union?

Yes.

Q8. Do you agree that ESMA's capacity to deliver effective supervision would be impaired where credit rating agencies conducted entirely or prevalently important operational functions, and in particular credit rating activities, in branches outside the EU?

No, as this can be perfectly justifiable for credit rating activities, in a case by case basis, for ratings of entities established or financial instruments issued in third countries, although always obeying to the

methodologies, procedures and conduct norms of the EU registered CRA, as is mentioned in paragraph 44 of the Consultation Paper ("Credit rating agencies should demonstrate that there is an objective reason for credit ratings to be issued in branches established outside the Union").

If in the future there is an EU-based CRA (meaning a CRA headquartered in the EU and registered with ESMA) competing internationally, it will be normal that most of its activity is outside the EU (although still having a strong activity in the EU), as many EU headquartered multinationals have.

What is necessary in that case is that:

- the branches outside the EU always obey to the methodologies, procedures and conduct norms of the EU registered CRA; and
- the EU registered CRA cooperates with ESMA in any needed information in the course of inspections or investigations, including on-site visits, regarding ratings or rating activities carried in non-EU branches.
- demonstrates that there is an objective reason for a credit rating to be issued in branches established outside the EU (and even this wording is incorrect, as the issue of a rating is considered to happen when it is published – article 4 (2) of CRA Regulation, and it can always be published centrally by the CRA's headquarters, never having published / issued ratings in branches, but only part of the rating analysis in branches),i.e., does not unduly relocate entirely (or prevalently) its rating activities through its branches to circumvent the endorsement regime or to create "empty boxes" / "empty shells" in the EU.

Specific disclosure best practices

Paragraph 62 of the Consultation paper states:

"Credit scores or ratings are distributed to the public in the EU when they are disclosed to an undetermined or undeterminable generality of individuals domiciled in the EU. Credit scores or ratings are also distributed to the public when they are issued through a website registered with a domain corresponding to one of the Member States of the EU."

Q9. Do you agree with the disclosure best practices indicated above and with their remit?

Yes, although CPR suggests including in the best practice in paragraph 62 the case when the issuing entity is domiciled in the EU, changing it to:

"Credit scores or ratings are distributed to the public in the EU when the issuing entity is domiciled in the EU, when they are disclosed to an undetermined or undeterminable generality of individuals domiciled in the EU or when they are issued through a website registered with a domain corresponding to one of the Member States of the EU."

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Q10. Do you agree that credit scoring firms and export credit agencies that distribute their products to the public in EU should consider ESMA's suggested disclosures that such scores or ratings are not issued in accordance with the CRA Regulation?

Yes, with the change suggested in the previous answer.

Q11. Do you agree with ESMA recommendations that the credit scoring firms and export credit agencies retain full responsibility for the disclosure indicated above when their scores or ratings are distributed to the public in the EU via agreement with third parties?

Yes, with the change suggested in the previous answer.

Other: CPR suggests including another best practice stating with a text adapted from the conclusion of the practical example 6) in paragraph 59 of the Consultation Paper, namely:

"All entities that are not registered CRA under CRA Regulation should remove any reference to "ratings" in the credit assessment sense of the word and clarify that any symbols they use do not constitute credit ratings, to avoid misinterpretation of the service they provide".

Enforcement of the scope of the CRA Regulation.

Paragraph 69 of the Consultation Paper states that:

"ESMA shall impose periodic penalty payments (…) and impose fines where appropriate, in accordance with Articles 36(a) and 36(b) of the CRA Regulation. This applies also to registered credit rating agencies that create impediments to the effective supervision from ESMA by carrying out entirely (or prevalently) important operational functions in branches outside the EU."

As mentioned above, as, in establishing branches outside the EU where some credit rating activities may be executed, there may be no intention to create impediments to the effective supervision from ESMA, it should, once again be explained that "by carrying out entirely (or prevalently) important operational functions in branches outside the EU" (namely some credit rating activities), ESMA's capacity to deliver effective supervision will not be impaired as long as this is justifiable, in a case by case basis, for ratings of entities established or financial instruments issued in third countries, as long as:

- the branches outside the EU always obey to the methodologies, procedures and conduct norms of the EU registered CRA;
- the EU registered CRA cooperates with ESMA in any needed information in the course of inspections or investigations, including on-site visits, regarding ratings or rating activities carried in non-EU branches;

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- demonstrates that there is an objective reason for a credit rating to be issued in branches established outside the EU (and even this wording is incorrect, as the issue of a rating is considered to happen when it is published – article 4 (2) of CRA Regulation, and it can always be published centrally by the CRA's headquarters, never having published / issued ratings in branches, but only part of the rating analysis in branches),i.e., does not unduly relocate entirely (or prevalently) its rating activities through its branches to circumvent the endorsement regime or to create "empty boxes" / "empty shells" in the EU.

Q12. Do you agree that ESMA should take action to prevent any entity from abusively distributing credit ratings in the EU?

For the mentioned reason, although agreeing with Q12, CPR suggests that ESMA amends the last sentence of the Proposed Guideline in paragraph 69 ("This applies also to registered credit rating agencies that create impediments to the effective supervision from ESMA by carrying out entirely (or prevalently) important operational functions in branches outside the EU") to:

"This applies also to registered credit rating agencies that create impediments to the effective supervision from ESMA by carrying out entirely (or prevalently) important operational functions in branches outside the EU without an objective reason to do so or without:

- guaranteeing that the branches outside the EU will always obey to the methodologies, procedures and conduct norms of the EU registered CRA;
- guaranteeing the cooperation with ESMA in any needed information in the course of inspections or investigations, including on-site visits, regarding ratings or rating activities carried in non-EU branches; and
- demonstrating that there is an objective reason for a credit rating analysis to be done in branches established outside the EU,i.e., does not unduly relocate entirely (or prevalently) its rating activities through its branches to circumvent the endorsement regime or to create "empty boxes" / "empty shells" in the EU."

Lisbon, February 20th, 2013

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