



Per E-Mail

Mr. Fabrice Demarigny
Secretary General
Committee of European Securities Regulators
11- 13 Avenue de Friedland
F 75008 Paris
France

Contact
Rudolf Siebel
Tel.: 069/154090-255
Fax: 069/154090-155
rudolf.siebel@bvi.de

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**CESR's Questionnaire on the Day-to-Day Application of the IOSCO
Code by the Credit Rating Agencies
Ref: 06-312 dd. 6 July 2006**

Dear Mr. Demarigny,

In response to your questionnaire please find below the German association of investment fund and asset managers' answers on the subject at hand. Our 80 member companies manage close to EUR 1,400 billion in both retail and institutional investment funds as well as mandates. We hope you will find our comments helpful.

We would like to answer your questions as follows:

- 1. Do you know of cases where the methodologies used by CRAs were not consistently applied or where changes of methodologies were not clearly explained and disclosed?**

As a trend the major CRAs aim at consulting with the market place before enacting methodology changes. However, for example, in the past S&P changed its assessment of pension liabilities of (German) companies and combined this with an unexpected downgrade of a company. Both actions occurred without in-depth consulting with the market. It remains highly questionable why S&P did not use a US based company as a test case for this switch in methodology.

Hauptgeschäftsführer:
Stefan Seip
Geschäftsführer:
Rüdiger H. Päsler
Rudolf Siebel

Eschenheimer Anlage 28
D-60318 Frankfurt am Main
Postfach 10 04 37
D-60004 Frankfurt am Main
Phone: +49 69 15 40 90 0
Fax: +49 69 5 97 14 06
info@bvi.de
www.bvi.de

2. Do you know of ratings based on inaccurate information or issued without the credit rating agency having taken into account all relevant information?

Investors are seldom informed about cases where the issuer claims that the rating is based on missing or inaccurate information. For example, Fitch was widely criticized by the German insurance industry on its methodology for public information based life insurance ratings.

3.1 Do you consider that the CRAs devote sufficient resources to assign high quality credit ratings?

We consider that the three major CRAs in general devote sufficient resources to their credit research. At times, however, the CRAs' staff does not answer questions of investors in a timely fashion.

3.2 Do you consider the CRAs devote sufficient resources to assign high quality credit ratings of structured finance instruments and to monitor them on an ongoing basis?

Our members believe the major CRAs in general do a good job in the initial rating process of structured finance deals prior to and at issuance. They force issuers to maintain a certain level of credit quality which investors would not be able to do in absence of the CRAs. The research analyst capacity devoted by the CRAs to structured finance could be more in line with market requirements. It seems that CRAs do not always take into consideration that there are times of high issuance. Our members feel that the CRAs sometimes are not able to issue in time all pre-sale reports especially when there are more deals in spring and autumn.

Our members believe that the CRAs allocate insufficient resources to the monitoring of rated deals. The monitoring reports and rating actions are often not issued on a timely basis. On some deals, the outcome of the surveillance of the CRAs is not visible to investors at all, i.e. no reports or the like are published. In some cases there remains the impression that surveillance is not done at all until the deal runs into problems or investors ask for a report on a specific deal. The quality of the monitoring reports all in all is considered sufficient although factual mistakes and wrong data are not uncommon. It is also not unusual that the CRAs' staff does not answer questions of investors in a timely fashion. Our members also report cases where CRA staff does not even respond to e-mails.

Structurally, information disclosure on structured finance deals is not on equal terms to all parties involved in the deal. CRAs and equity-tranche-investors usually get more and earlier information than investors.

Our members would like to get access to the more detailed regular information, especially the “issuer reports” or “trustee reports” which the CRAs receive. Currently our members have access only to the regular CRA investor report on a deal. It seems odd that investors who bear the financial risk receive less information than the CRA.

4. Do you consider that the period of time during which the rating decisions, the rating reports and the updates are publicly available is sufficient?

Not all the information mentioned in the question will be publicly available to all investors. Press releases and ratings listings usually are available for a sufficient time while in depth research reports on single issue(r)s are limited to paying subscribers.

5. Is it always clear to you which are the critical elements underlying the rating decision (including its updates)?

Since the CRA may rely on insider information from the issuer which is not communicated to the market, some or all critical elements underlying a rating decision are not disclosed to investors. It is important that the rating agency discloses on all ratings whether the issuer has participated in the rating process in order to assess whether the rating outcome may be influenced by privileged information.

6. Do you think the ongoing surveillance of CRAs on ratings, which can result in a rating action, is effective and timely?

CRAs were criticized because of perceived slow response rates in high profile cases such as Enron or Russia. However, it needs to be taken into account that the CRA should not push an issuer into default, which may make it necessary to postpone rating action during a restructuring. In this respect we welcome Moody's recent consultation on the envisaged methodology for rating changes in event risk cases. The two US based CRAs tend to be slower than their European counterpart when it comes to taking rating actions on the US government (e.g. when Congress fails to pass the budget) or on US government sponsored entities (such as FannieMae). In any case our members would welcome if the period during which a credit is on a rating watch list could be limited, e.g. to 3 months.

7. Have you ever experienced (or heard about) situations where CRA or its employees have given any assurance or guarantee of a particular rating prior to rating assessment?

This behaviour is the general rule in case of structured finance ratings where the issuer and its bank structure the deal towards obtaining a specified rating level.

- 8.1 Do you consider that the CRAs disclose clearly in the rating decision whether**
- a) the rating was not initiated at the issuer's request?**
 - b) the issuer has not participated in the rating process?**

Given the fact that the major CRAs are more and more refraining from issuing unsolicited ratings, such disclosure is rare. However, the situation may change from industry to industry. For example, Fitch's public information based ratings for Germany life insurers were at the center of a public debate a short while ago.

- 8.2 Is the abovementioned disclosure valuable to you?**

The CRA is without privileged insider information when the issuer is not participating in the rating process. Therefore the information that the issuer has not participated in the rating process means that the rating is based only on publicly available information. This fact is very valuable for the assessment of the quality of a credit rating and should be disclosed in all ratings. This disclosure is more important than the disclosure whether the rating was initiated at the issuers request.

- 8.3 Do you know of cases where the ratings of the type mentioned above (a and b) had a lower degree of quality than others?**

This question cannot be answered in the affirmative because in these cases there is by definition no higher quality rating with issuer participation. In case of the Fitch's public information based ratings for German life insurers the German insurers pointed out a number of specific reasons why such ratings seem to be of lower quality.

- 9. Have you ever experienced (or heard about) situations where the CRA has denied the issuer the opportunity to clarify any likely factual misperceptions or matters that the CRA should be aware of prior to issuing or revising the rating?**

No, however, we are also not aware of situations where a rating agency confirmed publicly that it changed a rating because it clarified factual misperceptions or got knowledge of matters that the CRA should have been aware of prior to issuing or revising a rating.

- 10. Are you aware of cases where the rating decision was influenced by pressures from the issuers or other parties?**

No.

11.1 Do you consider that the CRAs have put in place adequate separations and firewalls between credit rating analysts and staff involved in other businesses (such as rating advisory, consulting, credit assessment, research)?

We do not believe that S&P has put in place adequate separations and firewalls between credit rating analysts and staff involved in other businesses. We are referring in particular to the increased attempts of Standard & Poors to press European investors into signing licence agreements on the international securities identification numbers (ISINs) which the S&P CUSIP Service Bureau (a department within the CRA) issues on US securities. In particular, the use of the rating agency name S&P in letters and (local) rating agency staff and management personnel to push market participants into signing licence agreements for these not ratings related data services has put our member firms under perceived pressures by a rating agency. This threatens the integrity of the rating agency.

Such conduct of business which is not related at all to the ratings business should be prohibited by regulators. A strict legal and operational separation at all levels of the firm of such activities from the rating business should be considered as condition sine qua non in the IOSCO Code and in any rating agency registration process with national regulators.

In this context it is naive to focus only on the rating analyst level, as question 11.1 seems to suggest. In order to be effective, separations and firewalls between ratings and non-ratings businesses need to be in place from the lowest to the highest management levels of the CRA. Only with clear separation of management any inducements to use one business to support the other will be effectively reduced. This is clearly not the case with S&P. For example, Torsten Hinrichs, MD Frankfurt office sells both S&P ratings and non-rating services in Germany. At a more senior level James D. Taylor, VP and MD S&P Global Settlement Services (non rating services) is reporting to Vicky Tillman who is MD of Ratings Global.

11.2 Have you ever been in contact with credit rating analysts for other services than the one they provide within the context of credit rating?

We believe question 11.2 is too narrow in its focus on the contact at the rating analyst level. Only a clear separation of management for the various services which S&P provides to the public may remove inducements to use the ratings business to support the other businesses. We and other European investors dealt in the past with S&P analyst level and management personnel on other services than credit ratings, namely ratings data and other non rating services such as CUSIP contracts without being assured that these persons are not connected to the ratings side of the business. At least for Torsten Hinrichs, it is public information that he sells both S&P ratings and non-rating services in Germany.

- 12. As an issuer, have you ever negotiated the fees of the rating service with analysts involved in the rating process?**

No.

- 13. Have you experienced any situation where the rating disclosure was not done in a timely manner?**

Concerning the timeliness of rating decisions, reports and updates, CRAs tend to be slower in their credit assessment than the market. The spread on a weakening corporate credit will usually widen some time before a CRA is issuing a rating action. On the other hand we recognize that CRAs do not aim at making buy/sell recommendations but try to assess the credit quality of an issuer over a full economic cycle which makes timeliness of research less of an issue.

- 14. Have you encountered any problems in relation to the use of confidential information in your day-to-day business with the CRAs?**

No.

- 15. Do you know of cases where the credit rating agencies are not applying the provisions of their own codes of conduct?**

No, however, we would like to point out that investors are not in a position and do not have the resources to check on the compliance of all CRAs with their codes of conduct.

- 16. Are there any other comments you would like to make?**

The barriers to entry into the CRA market are historically first and foremost a function of the introduction and restrictive application of the NRSRO status in the US which over time has led to a very limited number of acceptable rating agencies (and even this limited number has been reduced by market exits). As a result, the major CRAs may charge very high prices both for ratings and ratings data information services not only to issuers but also to investors. Additionally, CRAs increasingly use their pricing power to charge for all steps along the rating value chain.

On the issue side, for example, the large CRAs charge additional shadow rating fees well in excess of EUR 10,000 for each unrated issue which is part of the underlying portfolio of a structured finance deal (e.g. a CDO deal). The shadow rating is usually of lesser quality, e.g. a pure quantitative analysis in case of Moody's ("KMV rating"). Furthermore, the CRA will usually not accept ratings from another CRA on these issues. This means the CDO manager has to pay the additional shadow rating fee even if the

issuer is rated by another rating agency which pushes up rating costs considerably. CDO managers cannot avoid the additional, at times very high, shadow rating fees because structured finance issues are not marketable at all without a rating.

On the investor side, for example, S&P charges a separate “data pass through fee” to investors in case of rating data feeds which are not obtained directly from the CRA but which are delivered (under a full licence by S&P) through a third party provider, e.g. the German WM-Daten. In this way market access to ratings data through third party data providers will be more limited in the future.

Going forward, the pricing policies of the large CRAs need to be reviewed by the competition authorities.

Our response can be made public.

With kind regards

BVI Bundesverband Investment und Asset Management e.V.

(signed)
Rudolf Siebel LL.M
Managing Director

(signed)
Marcus Mecklenburg
Director