

**EFAMA RESPONSE TO CESR CONSULTATION PAPER:
THE ROLE OF CREDIT RATING AGENCIES IN STRUCTURED FINANCE**

I. INTRODUCTORY REMARKS

The European Fund and Asset Management Association (EFAMA)¹ welcomes the opportunity to comment on CESR's assessment and proposals with regard to the role of credit rating agencies in structured finance.

EFAMA's members are important investors in bonds and therefore review ratings by credit rating agencies as part of their investment process. Moreover, one can observe further integration of ratings into other regulatory regimes (i.e. CRD) which gives them more weight. Therefore, EFAMA has a keen interest in a well-functioning market of credit rating agencies.

EFAMA agrees with most of CESR's assessments and proposals, notably in the field of transparency, monitoring and conflict of interest. An update of the IOSCO Code of Conduct to strengthen certain provisions in these areas will also have our support.

However, there is no consensus as to the question whether the (reviewed) IOSCO Code of Conduct is a sufficient regulatory response or whether binding legislation is needed.

II. DETAILED RESPONSES TO THE QUESTIONS

Transparency

80. Do you agree that the CRAs need to make greater on-going efforts to clarify the limitations of their ratings?

Clearer communication of the central characteristics and limitations of structured finance products ratings would be useful and desirable. However, EFAMA believes that its members, as professional investors, understand that a rating does not actually tell the investor anything about

¹ **The European Fund and Asset Management Association (EFAMA)** is the representative association for the European investment management industry. Through its member associations from 20 EU Member States, Liechtenstein, Norway, Switzerland and Turkey, as well as its corporate members, EFAMA at year-end 2007 represents over €16.5 trillion in assets under management, of which €7.9 trillion through over 46,000 investment funds.

the value or the liquidity of the instrument at any point in time. Hence, professional investors are (or at least should be) aware of the fact that significance of ratings is limited.

90. Do you agree with CESR's view that although there has been improvement in transparency of methodologies, the accessibility and content of this information for complex structured finance products requires further improvement in particular so that investors have the information needed for them to judge the impact of market disruption on the volatility of the ratings?

Yes. CRAs should also publish their key model assumptions, weightings of key parameters and correlations as well as the effect of changes in assumptions and correlations so that investors can assess these underlying assumptions and judge the impact of market disruption on the volatility of ratings. CRAs should make available the base case expectations and assumptions, i.e. the distribution (mean, sigma) over time of expected defaults in the asset pool. Stress cases should be added as well as a comparison of the base case of the deal to the behaviour of the structured finance subsector in the region.

One EFAMA member suggests that all this information should be included in the pre-sale report to allow investors to make an informed decision.

97. Do you agree that there needs to be greater transparency regarding the specific methodology used to determine individual structured finance ratings as well as rating reviews?

Yes. EFAMA believes that investors have to know whether a rating has been changed due to a change in methodology or in performance of the asset pool.

Moreover, some of our members question the timing of some of the recent mass rating changes. Sometimes CRAs seem to be late or at least reluctant to change ratings. For instance, structured finance deals in line with performing assets and significant improved credit enhancement usually do not seem to receive an upgrade on time. Therefore, CRAs should improve the rate of deal specific rating actions versus mass rating changes.

Finally, several EFAMA members agree on the necessity for a clear labeling of ratings (pre and post sale) to indicate against which version of a methodology those ratings were based on, including a link to the specific model.

100. Do you agree that there needs to be greater public and standardised information on structured products in the EU? How would this best be achieved?

Some EFAMA members see a necessity that CRAs be required to make provisions in their rating contracts that the ratings on all tranches of a structured finance deal have to be disclosed to prevent issuers/arranging banks from suppressing the publication of ratings they do not deem necessary and to enable investors to make an informed decision in light of all ratings on a specific deal.

In addition, some EFAMA members would like to see the principle established whereby a structured finance rating can only be assigned to a specific deal if a standard set of minimum disclosure criteria is provided for by the CRA in the investor reports.

Other EFAMA members would like to refer CESR to the report of the European Securitization Forum (ESF) to the European Commission on this issue.

Monitoring

104. Do you agree with CESR that contractually set public announcements on structured finance performance would not add sufficient value to the market to justify the cost and possible saturation of the market with non-material information?

Yes, EFAMA agrees.

CESR might want to give further consideration to the idea that although parameters monitored by CRAs can be compared with e.g. trigger levels, one could require that such parameters should be compared with the CRAs base case assumptions for the particular transaction (e.g. RMBS) when applicable (example: pool performance regarding defaults/90+ days delinquencies versus the base case expectations that are based on the collateral composition (e.g. LTV, DTI, type of mortgage)). As the CRAs have loan by loan data, the determination of a base case development of defaults/delinquencies could be easily created. This would give the investor a sense of whether a deal is performing in line with the CRA's base case expectations.

112. Do you agree that the monitoring of structured finance products presents significant challenges, and therefore should be a specific area of oversight going forward? Are there any particular steps that CRAs should take to ensure the timely monitoring of complex transactions?

Yes, EFAMA agrees. There is a need for an incentive for the agency to devote more and better resources to monitoring. Moreover, there is a perceived need for timelier monitoring of deals. Some EFAMA members believe that it is necessary that investors do not only get access to the regular CRA investor reports, but especially to the "issuer reports" or "trustee reports" (which the CRAs receive) since they bear the financial risk. Free access for investors to monitoring data should equally be provided for.

Human Resources

118. Do you believe that the CRAs have maintained sufficient human resource, both in terms of quality and quantity, to adequately deal with the volumes of business they have been carrying out, particularly with respect to structured finance business?

Views at EFAMA are split as to whether human resource was sufficient both in terms of quality and quantity. Members that were overall satisfied requested, however, that more resources should be allocated to the monitoring of rated deals.

120. Do you consider that the generally unaltered educational and professional requirements of CRAs' recruitment policies negatively impact the quality of their rating process, given the rising complexity of structured finance products?

No comment.

125. Do you agree there is a need for greater transparency in terms of CRA resourcing?

Most EFAMA members doubt that greater transparency in terms of CRA resourcing would help to ensure the high quality of ratings.

126. Do you agree with CESR that more clarity and greater independence is required for analyst remuneration at the CRAs?

Remuneration and other incentives that add to conflicts of interest should be addressed and properly managed.

Conflicts of interest

133. Do you see the level of interaction between the CRAs and issuers of structured finance products creating additional conflicts of interest for the CRAs to those outlined above? Do you believe that any of these conflicts are not being managed properly?

EFAMA has no opinion as to whether these conflicts are well managed or not.

134. Do you agree that greater transparency is required regarding the nature of interaction between CRAs and issuers/arrangers with regards to structure finance products and that there needs to be clearer definitions of acceptable practice?

Yes. Clearer definitions of acceptable practice should be considered by IOSCO.

138. Do you believe there needs to be greater disclosure by CRAs over what they consider to be ancillary and core rating business?

Yes. Some EFAMA members believe that such disclosure would require standardised definitions of “core” and “ancillary” across the industry to be able to address properly potential conflicts of interest.

142. Do you believe that the fee model used for structured finance products creates a conflict of interest for the CRAs? If yes, is this conflict of interest being managed appropriately by the CRAs?

A conflict of interest is very likely to appear. EFAMA has no opinion as to whether these conflicts are managed appropriately or not.

146. Do you agree with CESR that there needs to be greater disclosure of fee structures and practices with particular regard to structured finance ratings so as to mitigate potential conflicts of interests?

Some EFAMA members favour disclosure of fee policies by the CRAs whilst recognising that issuers usually do not disclose the costs of the rating since a certain element of fee negotiation is necessary between CRAs and deal arrangers. Others, however, point to the commercial sensitivity of such information as well as to the fact that the more the CRAs have to explain their practices, the more issuers will model to meet those practices and standards.

The current self-regulatory regime

164. Do you agree with CESR's view of the benefits and costs of the current regime?

Yes, EFAMA globally agrees with the assessment of the benefits and costs of the current regime.

An EU regulatory regime

170. Do you agree that CESR has correctly identified the likely benefits and costs related to formal regulatory action?

Yes, EFAMA globally agrees with the assessment of the benefits and costs of formal regulatory action.

Conclusion

177. Do you believe that the current self-regulatory regime for CRAs should be maintained rather than introducing some form of formal recognition/regulation?

Although EFAMA members agree with the assessment of the benefits and costs of self-regulatory and formal regulatory regimes, there is no consensus as to which approach would be the most suitable.

Most EFAMA members favour the existing self-regulatory regime whilst stating that the IOSCO Code of Conduct has to be strengthened. Several members warn against the use of ratings in regulation since such official recognition of ratings could cause investors and regulators to rely too much on what are merely opinions. Some argue that regulation of CRAs might raise barriers to entry which would harm competition and might reduce the flexibility of credit analysts.

Despite this agreement, some EFAMA members do not want to exclude regulatory action per se. In their opinion, the application of a strengthened code needs to be monitored by regulators (i.e. national regulators and/or CESR). If the code is not properly implemented, legislative action should be seriously considered by the European Commission (i.e. regulatory powers should be granted to supervisors, the voluntary code could be made binding).

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