

STANDARD & POOR'S RATINGS SERVICES RESPONSE DATED 7 AUGUST 2009 TO CESR CONSULTATION PAPER ON CRA CENTRAL REPOSITORY (CESR/09-579)

Standard & Poor's Ratings Services¹ ("S&P") welcomes the opportunity to comment on CESR's Consultation Paper ("the CP") on the CRA's Central Repository ("the CRep") as published by CESR on 9 July 2009.

We stand ready to work with CESR in a collaborative way to arrive at a framework that addresses the objectives of the EU Regulation and can be delivered without imposing undue resourcing and compliance costs on CESR and the CRAs involved.

As you are probably aware, S&P publishes annually corporate, structured finance and public finance ratings default and transition studies which provide significant detail on its ratings performance. These studies are posted on www.standardandpoors.com.

To the extent that the CP identifies data which goes beyond that contained in the published studies, it will be important to have a clear understanding as to the data which is readily available to CRAs without them having to undertake costly and time-consuming reconfiguration of that data.

In this respect, we welcome the statement in paragraph 37 of the CP that "*CESR is aware of the fact that a balance should be struck between the level of information required to meet the needs of users and compliance costs for credit rating agencies.*" This is consistent with the Opinion of the European Central Bank dated 21 April 2009 commenting on the proposal for a regulation of the European Parliament and of the Council on CRAs.²

High-level comments

As headline issues, we note the following.

- S&P would request that the material to be made available publicly in the repository be in a format that does not unnecessarily interfere with a CRA's ability to capitalise on and protect its intellectual property (that format could be "pdf" format, for example – instead of csv as proposed).
- We agree that the data requirements and time periods are appropriate, except as noted below. S&P can provide structured finance default data in a timely manner. We can provide historical information for the period before entry into force of the EU Regulation in line with the granularity presented in the CP, with the following major caveats: (i) granular regional and sub-sector data is subject to minimum size requirements for data sets; (ii) the proposed use of NACE codes for corporate ratings would force us to incur significant costs; and (iii) the inclusion of non-U.S. public entities (NACE codes P and Q) is problematic for us.
- The proposed treatment of ratings on subsidiaries is neither appropriate in our view nor feasible for us.

¹ Standard & Poor's Ratings Services, is comprised of (i) a separately identifiable business unit within Standard & Poor's Financial Services LLC, a wholly-owned subsidiary of The McGraw-Hill Companies, Inc. ("McGraw-Hill"), and (ii) the credit ratings business housed (and firewalled) within certain other wholly-owned subsidiaries of, or divisions of, McGraw-Hill. McGraw-Hill is a global business service provider in the fields of financial services, education and business information. S&P Ratings Services is one of the world's leading providers of independent credit ratings. S&P Ratings Services rates and monitors developments pertaining to rated issuers from its operations in more than 21 cities in 16 countries around the world. The global nature of the financial markets means that many of the individual instruments rated by S&P Ratings Services are traded on exchanges in several different countries and held by investors from around the globe.

² Paragraph 13 of the Opinion refers – in the context of the repository – to the need to find a balance "*between the level of information required to meet the needs of users and the compliance costs for credit rating agencies.*"

- We would incur substantial costs to provide meaningful “*performance*” data on S&P’s CreditWatch and rating outlook indicators. Calculating defaults conditional on CreditWatch and outlook status would be costly and, in our view, would necessitate the development of a new and complex methodology.

General comment

It is not clear from the CP when registered CRAs are expected to submit to CESR the first data set for the CRep. We suggest that CESR include in its Advice to the Commission a time-table for the setting up of the CRep and also indicate when the first data sets are expected to be provided by registered CRAs. We also suggest that CESR clarify whether the mid-year data sets as submitted would cover the most recent six-month (or 12-month) period or whether rolling data over 12 months, 3, 5, 10, 20 and 30 years would be requested. The latter would require substantial incremental cost for CRAs.

Specific comments

Section II Scope of the CRep (paragraphs 11-21)

We agree with the proposed scope of the CRep.

Please confirm our understanding that CRAs should exclude ratings that are based on guarantees, insurance, letters of credit (LOC) and other forms of credit substitution. CRAs should include ratings on the guarantors, insurers and LOC providers. These procedures would avoid counting multiple ratings (in some cases, thousands of ratings) for the same entity.

Performance data of corporate and government ratings is generally provided on an issuer (entity) basis, while structured finance ratings are predominantly provided on an issue (obligation) basis. Therefore, counts of ratings issued and withdrawn, as well as default rates, transition rates and accuracy ratios, should also be provided on those bases. In this respect, we draw CESR’s attention to the statement in paragraph 31 that suggests that structured finance statistics would be available on an issuer basis.

Section IV – Potential for Setting Common Standards for the Presentation of Information

A. General standards

A.1 Rating Categories (paragraph 40)

We note that rating definitions may differ among CRAs, especially with respect to whether ratings are primarily indicators of default risk, expected loss or overall creditworthiness. These differences may lead to differing designations of default by CRAs.

A.2 Data Categories (paragraphs 46-60)

Regarding the proposed segmentation and supplementing comments made elsewhere, we note that the use of rating modifiers is too granular in segments other than global corporate, global structured finance and U.S. public finance ratings. Segmentation by both sub-sector and region together may be too granular in many cases.

For corporate issuer ratings, we suggest including vintage year (the year the issuer was first rated).

Our historical data does not contain sufficient information for us to distinguish between rating withdrawal reasons as is proposed in the CP. For structured finance ratings, nearly all rating withdrawals result from repayment of the obligation.

We suggest that CRAs explain how withdrawn ratings are treated in their default rate calculations. In our view, default rates for a given period should not be computed "*net of withdrawals*," as stated in the CP. Rather we believe the default rate should be calculated by dividing the number of defaults during the period by the total number of ratings at the beginning of the period, including in the denominator those ratings that are withdrawn during that period. After a rating is withdrawn, it is excluded from the denominator for subsequent periods. The transition matrix reveals the percentage of ratings withdrawn during each measurement period.

Please confirm our understanding that separate local currency and foreign currency rating data should be provided only for sovereigns and not for other public finance issuers.

We note that a default rate for multiple periods is not necessarily the same as a cumulative default rate. For example, one can calculate a simple three-year cumulative default rate for the three years ended 31 December 2008, a single three-year period. One can also cumulate one-year default rates, conditional on survival, for the same three years. Another variation is to calculate cumulative average default rates for multiple three-year periods.

We believe that CreditWatch and rating outlook status are predictive of future rating changes, as demonstrated in the attached article entitled "*CreditWatch And Rating Outlooks Provide Powerful Warning Signals*" (dated 7 August 2007). We do not support a requirement to include CreditWatch listing and outlook status in "*performance*" statistics as proposed because CreditWatch listings and rating outlooks are short-lived, by definition. Thus, looking at data only at the beginning and end of a one-year period will miss most activity. We believe the "*performance*" of S&P's CreditWatch and rating outlook indicators is best evaluated by measuring both the percentage of rating changes preceded by CreditWatch and outlook indicators and the percentage of CreditWatch and outlook indicators followed by rating changes. The latter is probably more meaningful because these indicators are not intended to precede all rating changes. A CreditWatch listing focuses on identifiable events and short-term trends that cause ratings to be placed under special surveillance by S&P's analytical staff when they are awaiting some additional information; otherwise the rating is immediately changed or affirmed. CRAs will incur substantial costs to provide meaningful data on CreditWatch and rating outlooks. (Please see related comments in relation to section V.B.1.)

A.3 Time periods (paragraphs 61-67)

We note that structured finance obligations have an average life of about five years. In light of their short tenor, it is generally not meaningful to report default or transition rates for these ratings for a time horizon longer than 10-12 years.

We would be more comfortable with information required within three, rather than two, months after the end of a particular period.

There seems to be a discrepancy between paragraphs 63 and 66. Paragraph 63 says CRAs should provide data for the most recent 1, 3, 5, 10, 20 and 30 years, but paragraph 66 calls for historical rating performance covering only the last ten years before entry into force of the EU Regulation.

We support the proposed treatment of unsolicited ratings.

B. Specific standards for corporate ratings

B.1 Geographic breakdown (paragraphs 77-80)

In addition to reporting data for each region, we suggest reporting the global total.

The Middle East & Africa region is not likely to have a sufficient number of ratings to meet the minimum requirements. We suggest combining this region with Europe or only including it in the global data set.

B.2 Industry segmentation (paragraphs 81-82)

Separate data can be reported easily for banks, utilities and insurance companies. It would, however, be very difficult to segment our other corporate ratings according to NACE codes because we do not currently include those in our database. Segmenting the corporate sector by NACE codes as indicated in the CP would require a significant and costly reconfiguration of our data. We suggest combining all corporate sectors other than banks and insurance. This would also achieve consistency with U.S. SEC data requirements.

If NACE codes must be used, special purpose trusts and other issuers of structured finance securities (included in NACE code K) should be excluded from the corporate sector.

B.3 Treatment of subsidiaries' ratings (paragraphs 83-86)

The proposed treatment of subsidiaries seems to have two goals: 1) establishment of a common methodology for all CRAs; and 2) not counting “*the same entity*” multiple times. We believe the latter is more important and Standard & Poor’s has long employed a methodology for excluding “*rating identities*” from its rating performance studies.

The proposed treatment of subsidiaries’ ratings (i.e. excluding subsidiaries “*where the subsidiary can be regarded as fully integrated in the parent company,*” meaning that “*the ratings of the subsidiary usually reflect the ratings of the parent or the subsidiary has no debt or securities in its own right*” is neither analytically appropriate in our view nor feasible. We do not have the information to classify hundreds (perhaps thousands) of formerly rated subsidiaries as proposed in the CP and it would be extremely difficult to classify currently rated subsidiaries as proposed.

We believe the CP’s proposed treatment of subsidiaries is not adapted to the wide variety of fact patterns. For example, a parent company could be the main operating entity or it could be a highly levered holding company dependent on dividends from its operating subsidiaries to service its own debt. Holding companies are often rated lower than their main operating subsidiaries. In many cases, parent and subsidiary ratings move independently, but subsidiaries are rarely regarded as autonomous because a parent generally has the ability to remove assets or add liabilities to its subsidiary.

CRAs should be permitted to treat parent and subsidiary ratings as they deem appropriate, provided they disclose their methodology. Alternatively, we suggest the following objective approach, which we believe could be consistently applied by all CRAs, although this would entail significant costs for us and perhaps other CRAs. When affiliated companies have different credit ratings, each would be counted as a separate entity; when their ratings are identical, only one entity would be counted for a given time period. This would achieve both apparent goals.

B.4 Issuer ratings vs. debt rating, types of debt (paragraphs 87-88)

We suggest using only long-term corporate issuer (entity) ratings.

C. Specific standards for sovereign and public finance ratings

C.1 Geographic breakdown (paragraphs 89-92)

Given the relatively small number of rated sovereigns (about 125) a single global sovereign data set is more appropriate, in our view, than the proposed geographic breakdowns. For non-U.S. sub-sovereigns (about 320 issuers rated by S&P), there are insufficient ratings to divide them into meaningful sub-groups by region – in particular as they will be further divided into seven rating categories (or 19 if notches are used). Our public finance ratings are overwhelmingly on U.S. issuers (13,104 rated U.S. public finance issuers at the end of 2008). Given the vastly different number of ratings, it would not be meaningful to combine our U.S. and Canadian public finance ratings³.

C.2 Segmentation (paragraphs 93-96)

In addition to reporting data for each region, we recommend reporting the global total which would include supranationals.

Including non-U.S. public entities (NACE codes P and Q) would entail substantial costs for us.

D. Specific standards for structured finance ratings

D.1 Geographic breakdown (paragraphs 98-101)

Because there are relatively few structured finance ratings in the Middle East and Africa, we suggest combining this region with Europe or excluding Middle East and Africa from the regional segmentation. Similarly, the relatively small number of structured finance ratings in Latin America may suggest this region should not be the subject of separate statistics. All regions including those with smaller numbers of outstanding ratings would be included in the global data set.

D.2 Criteria used to define the nationality/region of issue (paragraphs 102-105)

We accept domicile of the underlying assets as being the appropriate primary criterion for geographic classification of structured finance ratings. If the domicile is varied or unclear, we suggest that CRAs be permitted to select the approach they view as appropriate, in light of the available data, provided it is disclosed. When assets are domiciled in multiple countries, it would be very difficult for us to determine which country accounts for the largest portion of the assets.

D.3 Asset classes (paragraphs 106-108)

Structured finance ratings are predominantly issue-based long-term ratings. Short-term issue ratings are assigned to short-term tranches of RMBS, CMBS, CDOs and other ABS. Long-term issuer ratings are assigned to structured investment vehicles (SIVs) and derivative product companies (DPCs). Short-term issuer ratings are assigned to SIVs, DPCs and special purpose vehicles that issue asset-backed commercial paper (ABCP). Data for issuer and issue ratings cannot be combined. Long-term and short-term ratings also

³ Please note that we do include the U.S. sovereign rating in our sovereign database.

must be separated. It is not clear whether CESR would expect, where relevant, data for these four separate types of structured finance ratings (long-term issue, long-term issuer, short-term issue and short-term issuer), each further segmented by region and sub-sector.

We agree with the proposed asset class definition subject to data set size minima, noting the separation of long-term/short-term ratings and issue/issuer ratings, and except for home equity lines, which we would prefer to classify as RMBS, rather than ABS.

Section V. Potential Output Design

A. Statistical significance of data (paragraphs 109-112)

Our answer is “yes” to the first two questions in paragraph 112. For data sets with fewer than 50 defaults, it may not be meaningful to calculate default rates for each rating category.

B. Structure of the information presented

We agree with the proposed scope of information presented in the table, except as noted below.

B.1 Number of ratings and rating actions (paragraphs 113-117)

CreditWatch listings and ratings outlooks are short-lived, by definition (90 days is the guideline for S&P's CreditWatch). Thus, looking at data only at the beginning and end of a calendar year (ignoring intra-period actions) would miss much valuable information and could yield distorted results. We recommend using the "event-to-event" methodology explained on pages 12-13 of the attached article entitled “*CreditWatch And Rating Outlooks Provide Powerful Warning Signals*” (dated 7 August 2007).

Calculating defaults conditional on CreditWatch and outlook status would be costly and, in our view, would necessitate the development of a new and complex methodology.

In addition to reporting counts of upgrades and downgrades, we suggest including the percentage of starting ratings that were upgraded and downgraded.

B.2 and B.3 (Cumulative) default and transition rates (paragraphs 118-133)

We support the concept that default rates, rating transition rates and accuracy ratios should be reported for a specific sub-sector or region only if there are a minimum number of ratings. In our view, the suggested minima are too low. For the broad rating classes, we suggest a minimum of 200 ratings, except for sovereigns, (these 200 ratings will be divided into seven grades with separate default and transition rates for each); and for the finer notch level, we recommend a minimum of 500 ratings (which will be divided into 19 grades).

Both the total number of rated issuers (or issues) and the number of defaults are important. We believe that sub-sector and regional default rates should be calculated only for data sets with a minimum of 50 defaults for broad rating classes and 150 defaults for the finer notches. Even if the total data set is large, if there are few ratings in a particular class (e.g. ‘CCC’) or notch (e.g. ‘AA+’), default rates for it may not be meaningful. Issuer and issue ratings must be separated; long-term and short-term ratings must be separated. We also suggest that corporate, government and structured finance ratings would be reported separately.

For a broader view of multi-year cumulative default rates (CDRs), we believe it is more meaningful to calculate CDRs conditional on survival, as explained in our corporate default study. Some methodological “details”, such as the treatment of withdrawn ratings, can have a substantial impact on the results.

Cumulative default and transition rates for 20 and 30 years are not appropriate for structured finance issue ratings, which have an average life of about five years. Nearly all ratings will have been withdrawn at the end of these long periods as a result of debt repayment.

B.4 Accuracy ratios (paragraphs 134-136)

We suggest that CRAs also provide 1-year, 3-year, and 5-year Gini coefficients combining data for the most recent 30 years (or as many years as are available).

We agree that a meaningful Gini coefficient can be calculated when there are only 25 defaults, although results likely will be more robust when there are more defaults. For short-term ratings, a one-year Gini coefficient is most appropriate, in our view. For structured finance ratings, Gini coefficients must be separately calculated for issuer and issue ratings.

We consider the Gini coefficient a good measure of rating performance for ratings that are defined as indicators of relative creditworthiness. We note, however, that the Gini formula in Annex IV of the CP is not correct (unless aP includes aR). It should be: $aR / (aR + aP)$. The denominator should be the entire area within the triangle. We have some reservations about the statement that the accuracy ratio can be estimated by the equation on page 37 of the CP.

C. Navigation in the central repository (paragraphs 137-141)

Standard & Poor’s would request that the material to be made available publicly in the repository be in a format that does not unnecessarily interfere with a CRA’s ability to capitalise on and protect its intellectual property (such as “pdf” format – instead of csv as proposed). Should CESR decide to make such ratings information directly available for downloading, then S&P would wish to impose certain conditions of use – including, but not limited to, user agreements prohibiting the use of the data for commercial purposes without a licence agreement; mandatory user information, ID and password to be stored and be made available to Standard & Poor’s.

D. Additional qualitative information (paragraphs 142-144)

We agree with the list of minimum information to be provided in the CRep.

CRAs should also provide a description of the methodology used to calculate data and statistics, including the treatment of withdrawn ratings, provided to the CRep.