Paris, 14th January 2005

Dear Secretary-General,

CESR recently issued a draft technical advice that it proposes to give to the European Commission on possible measures concerning credit rating agencies.

We wish to let you know our comments on this Consultation Paper.

First we must highlight the importance of recognising and implementing the code of conduct fundamentals in the different areas mentioned in the consultation. Indeed, as well as clarifying the professional ethics, the issuers pay great attention to the transparency of the credit rating process, the quality of information given to the market and to their relations with the agencies.

Of the different comments included in our response attached hereto, we feel it is particularly useful to highlight the following points :

The increased disclosure of the methodologies used and the changes made to these methodologies as well as enhanced dialogue between agencies and issuers are essential to a well informed, properly functioning market. However, in our view, those disclosure or dialogue should not be linked to conditions of feasibility or appropriateness and should take place in all circumstances prior to issuing or revising a methodology or a rating.

We feel it is just as essential to recognise a right of appeal on the part of the issuer to the agency (by the methods described in our response), to ensure the confidentiality of certain information and to keep the practice of issuing ratings unsolicited by the issuer within strict boundaries.

In view of these elements, we do not support the idea of requiring the issuer to organise a rating agency data room.

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If these various aspects, especially the implementation of an appeal procedure, are applied effectively and soon, we believe that the provisions of the IOSCO Code generally are sufficient.

Provided they are amended or completed by European provisions in the areas specified in our detailed response (section IV Regulatory options), it is unnecessary, at least in the short term, to deal with these issues by regulation.

Of the additional areas to be considered, we believe it to be particularly desirable for credit rating agency codes of conduct to provide for the establishment of a written contract containing some minimum provisions between the credit rating agency and the issuer.

Increase competition between existing agencies through contracts allowing greater adaptability

We do not believe that the existence of a small number of credit rating agencies creates adequate conditions for competition between these agencies. In particular, some contractual clauses commit issuers to approaching the same credit rating agency for a large number of issuances, which is liable to deprive the market of a necessary degree of flexibility and may lead to the production of ratings that are not entirely necessary.

In order to promote competition between credit rating agencies, it is therefore necessary to ensure greater contractual flexibility and *in practice* to allow issuers to approach them only once or only a limited number of times, according to their own needs. Nonetheless, in any case, agency codes of conduct should provide for the establishment of a written contract containing some minimum provisions between the credit rating agency and the issuer (for details, see section IV).

Ensure in advance the transparency of the methodologies and their changes

In order to ensure the integrity and transparency of the rating process for investors and issuers alike, the credit rating agency should systematically and publicly disclose in advance the methodologies and criteria and their modification (and not only “where feasible and appropriate”, as set out in provision 3.10 of the IOSCO Code Fundamentals with regard to material modifications of methodologies). As it is important, firstly, to understand the basis on which the ratings are made and, secondly, to assess in advance the reasons for the changes made to these methodologies and criteria as well as their scope and impact. This transparency is, moreover, especially important given that methodologies and criteria differ from one agency to the next.

Concerning CRAs methodologies themselves, we are of the view they do not necessitate a regulation by securities regulators.

Reinforce the dialogue between agencies and issuers prior to issuing or revising a rating

The ratings assigned by credit rating agencies are often capable of exerting significant effect on the prices of the securities of the issuer concerned.

To ensure that the market operates effectively and to guarantee the quality and fairness of the ratings, the rating process *in all circumstances* should permit real dialogue between rating agencies and issuers, and presentation of the ratings analyses / reports to the issuer *prior to issuing or revising a rating* (and not only "where feasible and appropriate", as set out in provision 3.7 of the IOSCO Code Fundamentals), thus enabling issuers *to check in particular that any factual statements are correct.*

The quality of the ratings and of the dialogue must be a priority and must not be sacrificed to time constraints in the publication of ratings, as issuers are already under an obligation to publish, as soon as possible, certain information that concerns them directly if this information is likely to have a significant effect on the prices of their securities ("ongoing disclosure obligation").

Do not make agencies responsible for disclosing or disseminating non-public information

Taking into account the responsibilities incumbent upon issuers for disclosure of information - in particular under the Market Abuse Directive - and the duty of confidentiality of agencies, we feel that credit rating agencies should not be required, or permitted, to disclose or disseminate non-public information given to them by issuers, as well as inside *or similar* information that issuers themselves have not disclosed. To avoid unduly disrupting the securities market and harming the issuer's interests, the issuer should be given a right to check that no confidential information is inadvertently disclosed by the credit rating agency, rather than disclose itself an imminent rating change, where the rating announcement would amount to disclosing such information.

Also it should be explicit that the issuer is under no obligation to provide inside information to a third party, e.g. a credit rating agency, and that, had a third party access to such information, it would be subject to the provisions relating to insider dealing.

Recognise a right of appeal by the issuer to the agency

When differences exist between the issuer and the agency at the conclusion of the formulation phase of the draft report, it is essential that the issuer has a right of appeal to the agency, which should be able to be exercised before publication of the rating decision. The existence of such a procedure is likely to clarify the decision-making processes followed by agencies and hence to enhance the quality of information given to the market. In this context, the issuer must have access to an agency committee consisting of persons other than those who took part in the rating process. The issuer must have 24 hours in which to appeal and, in such case, the rating report must not be published before expiry of a 3 day period starting from the appeal date.

Keep the practice of issuing ratings unsolicited by the issuer within strict boundaries

The consultation report envisages that ratings unsolicited by the issuer may be made public. The effect or the objective of this practice may sometimes be to encourage a company to request a rating without having planned it before.
Furthermore, the publication of an unsolicited rating may co-exist with the publication of a solicited rating, which provides better guarantees in terms of quality and potential conflicts of interestIndeed, the quality of the ratings rests largely on the quality of the dialogue between the agency and the issuer. Such a dialogue must make it possible, in particular, to avoid misrepresentations regarding the fundamentals, the situation and the prospects of the issuer and avoid unduly disrupting the securities market, which an unsolicited rating does not necessarily permit.
For these reasons, we feel that the practice of the issuer providing unsolicited ratings should be kept within boundaries and, in particular, that such ratings should not be made public, especially when, within a group, unsolicited ratings on certain entities co-exist with the publication of ratings solicited by the issuer.

Do not oblige the issuer to organise a rating agency data room

We do not support the idea of requiring the issuer to organise a rating agency data room open to several or all credit rating agencies. Given the wide range of approaches / methodologies used by agencies on the one hand and the need to ensure or maintain a dialogue between credit rating agency and management on the other hand, it is neither pertinent nor conceivable in practice to provide for several credit rating agencies to have regular access to the same information and the same interlocutors.

We would be pleased to discuss these proposals further and thank you for your consideration of our views.

Yours faithfully

Alexandre TESSIER
Directeur Général

CESR'S TECHNICAL ADVICE TO THE EUROPEAN COMMISSION ON POSSIBLE MEASURES CONCERNING CREDIT RATING AGENCIES

DETAILED RESPONSE TO THE CESR CONSULTATION PAPER

I. INTRODUCTION

Definitions (Paragraphs 26-44) ; Use of ratings in private contracts in Europe (Paragraphs 45-53) ; Use of ratings in European legislation (Paragraphs 54-56)

Questions

1. **Do you agree with the definition of credit rating agencies? If not, please state your reasons.**

Yes

2. **Do you agree with the definition of credit ratings? If not, please state your reasons.**

Yes

3. **Do you agree with the definition of unsolicited ratings ? If not, please state your reasons.**

According to the CESR consultation paper, solicited ratings would be those where the initiative has been taken by the issuer. Otherwise the rating would be unsolicited.

CESR proposes to define an unsolicited rating as a credit rating produced by a credit rating agency on its own initiative.

We believe that an unsolicited rating should rather be defined as "a credit rating *published* by a credit rating agency on its own initiative *or on the initiative of a person other than the issuer*."

The focus should be much more on the publication of a credit rating than on its production, as the issues relating to unsolicited ratings result from their publication. Also ratings may be published on the initiative of third persons other than issuers and not on the own initiative of the credit rating agency.

4. Do you think that issuers should disclose rating triggers included in private financial contracts?

As mentioned in the consultation paper, this question is addressed in the Commission's Regulation N° 809/2004 implementing the Directive 2003/71 on the prospectus and in the CESR's consultation paper for the consistent implementation of that Regulation (CESR/04-225b).

We consider that this disclosure issue is addressed by the related regulations on prospectus and financial statements and therefore should not be the subject of additional requirements in the context of credit rating agencies.

In substance, information on the existence and nature of such clauses can only be relevant if there is a *serious likelihood that the triggering events will occur and if their possible impact is material.*

Rationale for our response

When an issuer's financial situation is, or becomes, problematic from the viewpoint of clauses covering default and accelerated credit obligations (banking covenants), information on the existence and nature of these clauses offers a useful indication of the impact on the financial situation, inasmuch as there is a strong likelihood that trigger events will occur, and their possible impact is material.

In other cases, it should be left up to the issuer to decide the (less useful) publication of the existence - or indeed the absence - of such clauses, or even details concerning these clauses.

Consequently, when it is unlikely that trigger events will occur and/or the issuer's situation is not very susceptible to the enforcement of such clauses, it must be possible for companies not to disclose this information.

Our comments in the context of the CESR Consultation Paper on Prospectus / Level 3

Regarding the CESR proposal quoted in § 52, we wish to highlight our response to the consultation paper CESR/04-225b :

"It appears difficult to supply *details on the measures taken or proposed* to palliate the effects of the application of a covenant, as these measures depend on both the issuer and lenders. Moreover, detailed compulsory publications would be likely to damage the issuer, notably in its relationships or negotiations with third parties.

In the event of implementing significant banking covenants for the company, we propose that the issuer provide information instead on how it intends to remedy the situation, with this last phrase then being drawn up as follows:
'Where a breach of covenant has occurred…., *the issuer should mention how he intends to remedy the situation*'."

5. Do you think that the use of ratings in European legislation should be encouraged beyond the proposed framework for capital requirements for banks and investment firms ? If yes, please provide examples.

No

II. COMPETITIVE DIMENSION : REGISTRATION AND BARRIERS TO ENTRY

Questions

1. Do you think there is a sufficiently level playing field between CRAs or do you think that any natural barriers exist in the market for credit ratings that need to be addressed ?

We do not believe that the existence of a small number of credit rating agencies creates adequate conditions for competition between agencies.

In particular, some contractual clauses commit issuers to approaching the same credit rating agency for a large number of issuances, which is liable to deprive the market of a necessary degree of flexibility and may lead to the production of ratings that are not entirely necessary. This applies in particular to private investments and investments intended for clearly identified credit institutions (in a syndication context) or for a retail customer base.

In order to promote competition between credit rating agencies, it is therefore necessary to ensure greater contractual flexibility and to allow issuers *in practice* to approach them only once or only a limited number of times, according to their needs. However, agency codes of

conduct should provide for the establishment of a written contract between the credit rating agency and the issuer in any case (see our response to question 4 in section IV).

We therefore wish to emphasise that the concept of ratings that do not entail ongoing surveillance is explicitly mentioned in the IOSCO Code Fundamentals (e.g. in provision 1.9).

2. **Do you believe that coverage of certain market segments or certain categories of economic entity (such as SMEs) may be sub optimal ? Are there measures that regulators could use to effect this scenario? Which are they, and would it be appropriate to use them ?**

No comment

III. RULES OF CONDUCT DIMENSION

Interests and conflicts of interest (Paragraphs 77—98)

Questions

1. **To what extent do you agree that in order to adequately address the risk that any conflicts of interest might adversely affect the credit rating it is sufficient to have the credit rating agency (i) introduce and disclose policies and procedures for management and disclosure of conflicts of interests, and (ii) disclose whether the said policies and procedures have been applied in each credit rating ?**

No comment

2. **Do you consider that to adequately address the risk that the provision of ancillary services might influence the credit ratings process it is necessary to prohibit a credit rating agency from carrying out those services? If your answer is yes, how would you address the entry barriers that could be created by imposing such a ban ?**

According to the consultation paper, the IOSCO measures "state *in general terms* (…) that ancillary businesses should be separated from the rating process". More specifically, the IOSCO Code Fundamentals (provision 2.5) provide that the credit rating business (…) should be separated from any other businesses *that may present a conflict of interest*". Also they explicitly recognize that ancillary business operations do not necessarily present conflicts of interest, and therefore do not provide for a prohibition on credit rating agencies to carry out such services.

A question may arise as to what is part of the rating process and what the terms "ancillary businesses" or "ancillary / additional services" encompass.

We believe that the provision of research or risk management services by a CRA *to the rated issuer* - rated entity or entity whose securities are rated - is likely to create conflicts of interest and thus should not be capable of being rendered to the rated issuer.

On the other hand, we believe that other services are part of the rating process, do not create conflicts of interest, and therefore should not be prohibited, *even if they are rendered by a credit rating agency to the issuer it rates*. This is especially so for rating advisory services that help issuers assess the impact on their rating of possible or certain transactions, e.g. acquisitions, investments, restructurings, ….

3. Do you think that structured finance ratings give raise to specific conflicts of interest that should be addressed in CESR's advice to the Commission ?

No

We do not believe that structured finance ratings give raise to specific conflicts of interest.

We agree with the idea in § 82 of the Consultation Paper that in a structured finance rating, the CRA involved might play a more active role than in the case of a corporate rating, for example advising the sponsor about the definition of the characteristics of the transaction according to the rating level desired for each of the tranches of the structure.

In any case we believe that this situation should be taken into consideration in a way that permits the CRA to play this role and the issuer (or sponsor) to adapt the features of the transaction in order to achieve the desirable outcome. This is already explicitly recognized in provision 1.14 of the IOSCO Code Fundamentals : "(…) This does not preclude a CRA from developing prospective assessments used in structured finance and similar transactions."

We should point out that, in this situation, the credibility of a credit rating agency is particularly at stake and constitutes an appropriate means to prevent any undue influence on the rating opinion and analyse.

4. **To what extent do you agree that in order to adequately address the risk that the provision of ancillary services might influence the credit ratings process it is sufficient to have the credit rating agency (i) introduce and disclose policies and measures managing and disclosing multiple business relationships with issuers in general and the issuer being rated in particular, and (ii) disclose whether the said policies and procedures have been applied in each credit rating ?**

Our comments below focus on point (i)

As mentioned in response to question 2 above (section III Interests and conflicts of interest), we believe that some services are part of the rating process and do not create conflicts of interest, *even if they are rendered by a credit rating agency to the issuer it rates*. This is especially so for rating advisory services, such as rating evaluation services (RES), which help issuers assess the impact on their rating of possible or certain transactions, e.g. acquisitions, investments, restructurings, discontinuing operations, ….

As such rating advisory services are part of the ratings services, we consider that it would be inappropriate to envisage disclosing the existence or nature of those services, notably in respect of multiple business relationships. Moreover, when they are related to possible transactions or decisions, such disclosure would particularly harm issuers' interests

5. **To what extent do you agree that in order to adequately address the risk that an issuer paying for a credit rating might influence its rating it is sufficient to have the credit rating agency (i) introduce policies and procedures, including but not limited to the introduction of a fee scheme, (ii) disclose its fee scheme and (iii) disclose whether the fee scheme has been applied in each credit rating ?**

No comment

6. **In order to deal with issues related to unsolicited ratings, to what extent do you agree that it is sufficient to have the credit rating agency (i) introduce and disclose policies and measures with regard to issuing unsolicited credit ratings and (ii) disclose when a particular rating has been unsolicited ?**

We feel that the practice of the issuer providing unsolicited ratings should be kept within boundaries and, in particular, that such ratings should not be made public, especially when, within a group, unsolicited ratings on certain entities co-exist with the publication of ratings solicited by the issuer.

The consultation paper envisages that ratings unsolicited by the issuer may be made public. The effect or the objective of this practice sometimes may be to encourage a company to request a rating without having planned it before.

Furthermore, the publication of an unsolicited rating may co-exist with the publication of a solicited rating, which provides better guarantees in terms of quality and potential conflicts of interest. Indeed, the quality of the ratings rests largely on the quality of the dialogue between the agency and the issuer. Such a dialogue must make it possible, in particular, to avoid misrepresentations regarding the fundamentals, the situation and the prospects of the issuer and avoid unduly disrupting the securities market, which an unsolicited rating does not necessarily permit.

7. **To what extent do you agree that in order to adequately address the risk that any financial or other link between a credit rating agency and an issuer might influence the credit ratings process it is sufficient to have the credit rating agency (i) introduce policies and measures managing and disclosing financial links or other interests between a credit rating agency and issuers or its affiliates or investments in general and the issuer or its affiliates or investments being rated in particular, (ii) disclose the said policies and procedures and (iii) disclose whether the said policies and procedures have been applied in each credit rating ?**

<u>Fair presentation</u> (Paragraphs 99-118)

- Levels of skills of agencies' staff (Paragraphs 99-103)
- Methodologies used for building credit ratings (Paragraphs 104-118)

Questions

1. **To what extent do you agree that in order to adequately address the risk that lack of sufficient or inappropriate skills might lead to poor quality credit ratings it is sufficient to have the credit rating agency (i) introduce policies and measures managing and disclosing levels of skills of staff, (ii) disclose the said policies and measures and (iii) disclose whether the said policies and measures have been applied in each credit rating ?**

No comment

2. **Do you have any alternative approaches to address the actual or potential risk that lack of sufficient or inappropriate skills might lead to poor quality credit rating assessments ?**

3. Do you think that undisclosed methodologies could lead to biased credit ratings or to biased interpretation of credit ratings ?

Yes

In order to ensure the integrity and transparency of the rating process for investors and issuers alike, it is *necessary that market players systematically are informed in advance of the methodologies and criteria used by agencies and their modification (and not only "where feasible and appropriate" as set out in provision 3.10 of the IOSCO Code Fundamentals).*

It is particularly important, firstly, to understand the basis on which the ratings are made and, secondly, to assess in advance the reasons for the changes made to these methodologies and criteria as well as their scope and possible impact on ratings. This transparency is, moreover, especially important given that the methodologies and criteria differ from one agency to the next.

Adequate disclosure of methodologies and their changes makes it possible to assess that they are sufficient to come to a reliable and objective credit rating, as rightly mentioned in paragraphs 105 and 115 of the CESR Consultation Paper.

4. Do you see more advantages or disadvantages in the regulation of CRAs methodologies by securities regulators? Please describe the advantages and disadvantages that you consider and which is the best way of dealing with them. Do you believe that this regulation would contribute in some ways to lead to common global standards for CRAs ?

The CESR consultation paper states in paragraph 117 that it could be appropriate to establish rules for specific aspects of methodologies, which could be in particular the following :
- Disclosure and explanation of the key elements and assumptions underlying the rating decision;
- Updating of ratings;
- The indication of some forms of risk warning on elements whose changes can mostly influence the credit rating, including a sensitivity analysis or other methods appropriate to describe the effects of changes of some relevant factors on credit rating.

The IOSCO Code Fundamentals contain a number of provisions aimed at ensuring the quality, fairness and correct understanding of the ratings :

- "The CRA and its analysts should take steps to avoid issuing any credit analyses or reports that contain misrepresentations or are otherwise misleading as to the general creditworthiness of an issuer or obligation."(1.6 under "Quality of the Rating Process) ;

- prior to *issuing or revising* a rating, *where feasible and appropriate*, "the CRA should inform the issuer of critical information and principal considerations upon which a rating

will be based and afford the issuer an opportunity to clarify any likely factual misperceptions or other matters that the CRA would wish to be made aware of in order to produce an accurate rating (…)." (3.7 under "CRA Responsibilities to the Investing Public") ;

- "when *issuing or revising* a rating, the CRA should explain in its press releases and reports the key elements underlying the rating opinion." (3.6 under "CRA Responsibilities to the Investing Public") ;

- "Except for ratings that clearly indicate they do not entail ongoing surveillance (…), the CRA should monitor (…) and update the rating by regularly reviewing the issuer's creditworthiness ;" (1.9 under "Monitoring and Updating")

We are of the view that these provisions move in the right direction and that CRAs methodologies do not necessitate a regulation by securities regulators.

However, fully in line with provision 1.6 of the IOSCO Code Fundamentals, we feel that their objective, which is essential, can only really be achieved by adding the following provisions or making the following modifications to the Code :

- The presentation of the ratings analyses / reports to the issuer should be systematic and thus should not be linked to conditions of feasibility or appropriateness. We feel it is therefore necessary *not* to take into account the expression "where feasible and appropriate" in provision 3.7 of the IOSCO Code Fundamentals;

- Except for ratings that do not clearly indicate they do not entail ongoing surveillance, a complete review should be carried out at least once a year by the rating agency in liaison with the issuer;

- In order to ensure that the market is kept fully informed, the agency should give the latest date of full review of the rating, whereas provision 3.3 of the IOSCO Code Fundamentals provides only for the publication of the date the rating was last updated.

5. Do you believe provisions of the IOSCO Code are sufficient, in terms of rules on CRAs' methodologies and the corresponding disclosure ? Do you believe that CRAs should disclose to issuers changes in methodologies before starting to use new methodologies ?

We believe that the draft IOSCO Code should be completed along the lines specified in our response to question 3 above, in particular to require CRAs to *systematicall*y disclose changes in methodologies to market participants, prior to their going into effect.

6. **Do you believe that regulation should concern all aspects of CRAS' methodologies ? How appropriate is the choice of explicitly regulating the four proposed issues (disclosure and explanation of the key elements and assumptions of a rating, indication of some forms of risk warning, rules on updating of ratings and the inclusion of some market indicators within a rating opinion)? Would you deal with these issues by self-regulation ?**

No, we do not believe it is suitable that regulation addresses all aspects of CRAs' methodologies.

The first three proposed issues can be appropriately dealt with by addition to or insertion in the IOSCO Code Fundamentals - with the changes proposed in our responses to questions 3 and 4 above (section III Fair presentation) - and by self-regulation.

With regard to the fourth proposed issue we would welcome clarification about the content and extent of the proposal - inclusion within a rating opinion of some market indicators, like credit spread and credit default swap -. As far as we are concerned, we believe that the information about the historical default rates would be enriched by other market quality indicators enabling to judge in particular the distribution and the levels of the ratings over a recent period (over the last 3 years for example) and their volatility over a preset period.

<u>Relationship between issuers and rating agencies</u> (Paragraphs 119-153)

Questions

1. **Do you consider that the combination of the requirements of the Market Abuse Directive in this area and the requirements of the current version of the IOSCO Code adequately address the issue of access to inside information by CRAs ?**

No

We do not consider that the combination of the two texts adequately addresses *in all respects* the issue of access to inside information, with regard to a possible subsequent dissemination of non-public information.

Taking into account the responsibility incumbent upon issuers for disclosure of information - in particular under the Market Abuse Directive - and the duty of confidentiality of agencies, we feel that credit rating agencies should not be required *or permitted* to disclose or disseminate non-public information given to them by issuers or inside information that issuers themselves have not disclosed.

We should point out that credit rating agencies are subject to the provisions relating to insider dealing. Therefore any disclosure of inside information by a credit rating agency or its staff would appear to constitute an offence under the Market Abuse Directive.

2. What is your view on requiring an issuer to itself disclose an imminent rating change where it has been advised of this by a CRA and where the rating announcement may itself amount to inside information in relation to the issuers' financial instruments ?

Background *(Paragraph 130 of the CESR Consultation Paper)*

Rating actions are likely to influence the prices of related financial instruments because of the additional information that CRAs usually have access to compared to the market as a whole. The Market Abuse Directive places the responsibility for disclosure of inside information on the issuer, which could be interpreted as requiring the issuer in these circumstances to itself announce the rating change before the CRA does. CRAs may give issuers an opportunity to check any factual statements are correct and to ensure that no confidential information is inadvertently disclosed by the CRA. It might be the case that a CRA would be far less willing to share such information with the issuer in advance of publishing the information if the result was going to be that the issuers themselves would disclose the rating.

For ratings that are compiled purely on the basis of publicly available information, it seems very unlikely that the rating will have an impact on prices. This suggests that those ratings based only on public information are far less likely to amount to inside information. (§ 130)

Response

We consider that a credit rating agency should not be required, or permitted, to disclose or disseminate non-public information given to them by issuers, as well as inside *or similar information* that issuers themselves have not disclosed. Therefore issuers should in any case be given a right to check that no confidential information is inadvertently disclosed by the CRA. Also we believe that the duty of confidentiality of the credit rating agency should be specified in a contract that in any case should be established between the agency and the issuer.

Do not require the issuer to disclose itself an imminent rating change

We believe that the issuer should not be required to disclose itself an imminent rating change, where the rating partly is compiled on the basis of inside information (the credit rating agency would have access to), or in the limited number of cases where the rating announcement would amount to disclosing such information (see next paragraph).

Insert a confidentiality clause in a contract between credit rating agency and issuer

As mentioned in our response to question 5 below (section III Fair presentation), the issuer is under no obligation to provide inside information to a credit rating agency. If it does, taking into account the *responsibility incumbent upon issuers for disclosure of inside information - under the Market Abuse Directive - and the duty of confidentiality of agencies,* we feel that the *use* of inside information by a credit rating agency *for rating purposes also may be adequately covered by a confidentiality clause, in a contract that in any case should be established between the credit rating agency and the issuer.*

In this respect we should point out that "*using, among other elements, inside information* (or, more generally non-public information) *in the rating process*" is not necessarily equivalent to saying that "the rating *amounts to* inside information (or non-public information)".

Do not allow a credit rating agency to disclose inside or similar information

As mentioned in our response to question 1 above (section III Relationship between issuers and rating agencies), we consider that a credit rating agency should not be permitted to disclose or disseminate non-public information given to them by issuers or inside information that issuers themselves have not disclosed. Similarly, *before the issuer itself discloses inside information, a credit rating agency should not be allowed to make a rating announcement in the limited number of cases where it would amount to disclosing inside information.*

Give issuers a right to check information in any case

It is important that the publications of ratings decisions do not unduly disrupt the securities market and do not harm the issuers'interests ; therefore *issuers in any case should be given a right to check that no confidential information is inadvertently disclosed by the CRA and, more generally, that any factual statements are correct.*

See also our other proposals in response to question 2 above (Section III Relationship between issuers and credit rating agencies)

3. **Do you consider that the requirements of the Market Abuse Directive in this area sufficiently address the risks that inside information might be disseminated, disclosed, or otherwise misused ?**

The Market Abuse Directive does not require credit rating agencies to make public inside information that issuers themselves have not disclosed.

Taking into account the responsibility incumbent upon issuers for disclosure of inside information - under the Market Abuse Directive - and the duty of confidentiality of agencies, we feel that credit rating agencies should also be *prohibited* from disclosing or disseminating non-public information given to them by issuers or inside information that issuers themselves have not disclosed.

4. **Are there any other issues concerning access to inside information which CESR should consider from the perspective of establishing a level playing field between CRAs ?**

See our response to question 1 above (under section II Competition dimension).

5. **Are there any other issues concerning the Market Abuse Directive's provisions concerning inside information that you consider to be of relevance to CRAs and their activities which need to be considered ?**

Yes

Under the Market Abuse Directive, issuers *may* disclose inside information to third parties in the normal course of their activities assuming that the recipient owes the issuer a duty of confidentiality.
It should be explicitly mentioned that the issuer is under no obligation to provide inside information to a third party, e.g. a credit rating agency.

As mentioned in our response to questions 1 and 2 above (section III Relationship between issuers and rating agencies), we consider that a credit rating agency should not be required, or permitted, to disclose or disseminate non-public information given to them by issuers, as well as inside or similar information that issuers themselves have not disclosed. Therefore issuers in any case should be given a right to check that no confidential information is inadvertently disclosed by the CRA.

Also we believe that the duty of confidentiality of the credit rating agency should be specified in a contract that in any case should be established between the agency and the issuer.

6. Do you consider that it would be helpful to have a dedicated regime governing CRAs and their access to inside information ?

To ensure that the market operates effectively and to guarantee the quality and fairness of the ratings, it is important that the rating process permits real dialogue between rating agencies and issuers.

As this dialogue primarily takes place within the framework of the bilateral relationships between the credit rating agency and the issuer, *it would not be helpful to have a dedicated regime governing the CRAs' access to inside information. However*, as mentioned in our response to question 5 above (under section III Relationship between issuers and rating agencies), *it should be explicitly mentioned that the issuer is under no obligation to provide inside information to a credit rating agency.*

With regard to the *use* of inside information, please also consider our views and proposals in response to question 5 above (contractual confidentiality clause; prohibition on the credit rating agency to disclose or disseminate inside or similar information; issuer's right to check that no inside information is inadvertently disclosed).

7. Is this provision sufficient to ensure that issuers have an opportunity to discuss and understand the underlying basis for any rating decision? If not, what other measures do you consider should be introduced?

Objectives

The increased transparency of the methods used and the changes made to these methods as well as enhanced dialogue between agencies and issuers are essential to a well informed, properly functioning market.

The Commission Directive 2003/125 highlights the objective of reliable and objective credit ratings by providing that credit rating agencies should consider adopting internal policies and procedures designed to guarantee that credit ratings published by them are *fairly presented*. (recital (10)).

Also we concur with the following statement in § 144 of the CESR consultation paper "It is clearly important that issuers and other market participants understand the methodologies employed by CRAs and that any changes to these are made public before they are implemented. It is also important for both the issuer and market participants to understand the key determinants for any particular rating to appreciate fully its meaning and relevance."

Response

It is unclear in the question which provision it refers to.

Based on the IOSCO Code Fundamentals, we consider that the provisions envisaged should be completed in certain respects, in particular by systematically ensuring in advance the transparency of the methodologies and their changes, reinforcing the dialogue between agencies and issuers, and recognizing a right of appeal on the part of the issuer to the agency (details below).

Also, while of the view that the provision 3.7 of the IOSCO Code Fundamentals moves in the right direction, we feel that its objective, which is essential, can only really be achieved if the presentation of the ratings analyses / reports to the issuer is systematic and thus not linked to conditions of feasibility or appropriateness. We feel it is therefore necessary not to take into account the expression "where feasible and appropriate" in provision 3.7 of the IOSCO Code Fundamentals.

Ensuring in advance the transparency of the methodologies and their changes

In order to ensure the integrity and transparency of the rating process and assess that they are sufficient to come to reliable and objective credit ratings, it is desirable that all market players - investors and issuers alike – systematically are informed in advance of the methodologies and criteria used by agencies and their changes.

It is therefore important, firstly, to understand the basis on which the ratings are made and, secondly, to assess in advance the reasons for the changes made to these methodologies and criteria as well as their scope and impact. This transparency is, moreover, especially important given that the methodologies and criteria differ from one agency to the next.

Reinforcing the dialogue between agencies and issuers

The ratings assigned by credit rating agencies are often capable of exerting significant effect on the prices of the securities of the issuer concerned.

To ensure that the market operates effectively and to guarantee the quality and fairness of the ratings, it is important to make sure that the rating process permits real dialogue between rating agencies and issuers prior to the publication or the revision of the ratings. This is particularly necessary due to the small number of agencies.

The quality of the ratings and of the dialogue must be a priority and must not be sacrificed to time constraints in the publication of ratings, as issuers are already under an obligation to keep the market informed at all times. Hence, European legislation obliges issuers to publish, as soon as possible, certain information that concerns them directly if this information is likely to have a significant effect on the prices of their securities. ("ongoing disclosure obligation").

Giving issuers a right to check information in any case

It is important that the publications of ratings decisions do not unduly disrupt the securities market and do not harm the issuers' interests. Therefore *issuers should in any case be given a right to check that any factual statements are correct.*

Recognising a right of appeal by the issuer to the rating agency

When differences exist between the issuer and the agency at the conclusion of the formulation phase of the draft report, it is essential that the issuer has a right of appeal to the agency. The existence of such a procedure is likely to clarify the decision-making processes followed by agencies and hence to enhance the quality of information given to the market (see details in our response to question 8 below).

8. In addition to being able to discuss the basis for a rating, should an issuer have a "right of appeal" where they disagree with the CRA's opinion?

Yes

As mentioned in our response to question 7 above (section III Relationship between issuers and rating agencies), we feel it is essential to recognise a right of appeal on the part of the issuer to the agency. This right of appeal should be capable of being exercised before publication of the rating decision, as specified below.

During the report drafting stage, it is conceivable that there may be differences of opinion between the agency and the issuer and that the latter may ultimately disagree with the report that the agency intends to publish.

Bearing in mind the consequences that the report may have for the issuer so as not to unduly disrupt the securities market, it is essential that the issuer has the right of appeal to the rating agency.

The right of appeal and the corresponding procedure, which should then be recognised in the fundamentals of the codes of conduct and implemented by the agencies, should contain the following elements:

- The issuer must have a period of 24 hours in which to appeal;
- The issuer must have access to an agency committee consisting of persons other than those who took part in the rating process;
- The rating report should not be published before expiry of a 3 day period starting from the appeal date.

9. Do you consider the provisions of the current draft IOSCO Code and the Market Abuse Directive to be sufficient to ensure that information published by CRAs is accurate ?

It is important that the publications of ratings decisions do not unduly disrupt the securities market.

In this respect, as mentioned in our responses to questions 2, 7 and 8 above (under section III Relationship between issuers and rating agencies), we consider that the provisions of the current IOSCO Code Fundamentals should be completed in certain respects, in particular by giving issuers a right to check that any factual statements by a credit rating agency are correct, as well as a right of appeal to the agency.

More specifically, we feel that the objective of the IOSCO provisions, which is essential, can only really be achieved if the presentation of the ratings analyses / reports to the issuer is systematic and thus not linked to conditions of feasibility or appropriateness. We feel it is therefore necessary not to take into account the expression "where feasible and appropriate" in provision 3.7 of the IOSCO Code Fundamentals.

10. Given the lack of specificity in the current draft IOSCO Code to maintain internal records for any particular time period, do you think more specific measures would be appropriate, requiring for example all the information received by a CRA to be kept, along with records supporting its credit opinions, for a minimum of 5 years ?

Yes, unless already provided for by existing laws or regulations.

In France, credit rating agencies are required to keep the records supporting their credit opinions for 3 years.

11. Do you consider that it would be appropriate to introduce measures requiring the establishment of a rating agency data room to ensure that all CRAs had access to the same information concerning a particular issuer ?

We do not consider it appropriate to introduce measures requiring the establishment of a rating agency data room or the access of several / all rating agencies to the same information from companies This is based on the following reasons :

- The approach and methodologies adopted vary from a credit rating agency to the other, implying that they do not need the same information from companies ;

- The quality of the ratings rests largely on the quality of the dialogue between the agency and the issuer. Such a dialogue must make it possible, in particular, to avoid misrepresentations regarding the rating assumptions and fundamental determinants, the situation and the prospects of the issuer and avoid unduly disrupting the securities market. As rightly mentioned in the CESR consultation paper, "The prospect of issuers having to devote the same attention to several or all CRAs that approach them is likely to place a significant burden on a company. This is particularly true given that (…) a significant amount of the non-public information that is provided to CRAs relates to strategy or the approach of senior

management to various issues - such information is likely to be difficult to compile in a "data room". Similarly, within decentralized structures, the approach of local management would not be facilitated by the establishment of a data room ;

- For ratings other than point in time ratings or ratings that entail ongoing surveillance, the quality of the dialogue is even more important, as information is evolving continually. There is thus a greater need to organize ongoing or regular exchanges of views between the issuer and the agency, as well as a need for the agency to carry out a complete review in liaison with the issuer (regularly, and at least once a year). Requiring companies to establish a data room would be particularly burdensome, time consuming and costly, without bringing any significant benefits to the public and to issuers ;

- As mentioned in the CESR consultation paper, the question is likely to occur in the context of unsolicited ratings, which we believe should not be encouraged (see rationale in our response to question 6 under section III Rules of conduct dimension – Fair presentation). In this context, an issuer may not be willing to share non-public information, or, where applicable, inside information, with several or all rating agencies ;

- The handling of potential conflicts of interest or management of such conflicts would be more difficult to address ;

- As we believe a credit rating agency in any case should be allowed to carry out ancillary services, if such services are not rendered to the issuer it rates (or to the issuer of the securities it rates), an access of several or all agencies to a data room would reduce the number of credit rating agencies that could provide ancillary services. (see our response to question 2 section I)

IV. REGULATORY OPTIONS CONCERNING REGISTRATION AND RULES OF CONDUCT FOR CREDIT RATING AGENCIES

<u>Regulatory options</u> (Paragraphs 168-192)

Questions

1. **Could you assess the policy options concerning the need for regulation or other measures, with particular reference to the practical implications for competition in the rating market and for the quality of ratings and of information to the market ? In particular :**
   - **A full registration/regulation regime based upon detailed criteria ;**
   - **A lighter registration/regulation regime essentially based upon the IOSCO Code;**
   - **To assess compliance to IOSCO Code Fundamentals in a parallel process to CRD's recognition;**
   - **A third party's certification or enforcement of the IOSCO Code;**
   - **Relying upon rules covering only specific aspects of CRAs' activity;**

- **Monitoring the market developments.**

See our response to question 4 (section III Rules of conduct dimension - “Fair presentation”)

2. **Could you please indicate your preferred option and highlight pros and cons that you see with regard to each policy option ?**

No comment

3. **Do you think the IOSCO Code of Conduct is conducive to reducing or increasing competition ?**

No comment

4. **Are there any areas where any European rules of conduct should be extended beyond the IOSCO Code ?**

Yes, we believe that European rules of conduct should be extended beyond the IOSCO Code Fundamentals in the following areas :

Disclosure of the methodologies and their changes prior to their going into effect (3.10 of the IOSCO Code Fundamentals)

In order to ensure the integrity and transparency of the rating process for investors and issuers alike, the credit rating agency should *systematically* and publicly disclose in advance the *methodologies and criteria and their modification* (and not only "where feasible and appropriate", as set out in provision 3.10 of the IOSCO Code Fundamentals with regard to material modifications of methodologies). As it is important, firstly, to understand the basis on which the ratings are made and, secondly, to assess in advance the reasons for the changes made to these methodologies and criteria as well as their scope and impact. This transparency is, moreover, especially important given that methodologies and criteria differ from one agency to the next.

Concerning CRAs methodologies themselves, we are of the view they do not necessitate a regulation by securities regulators.

Dialogue between agencies and issuers prior to issuing or revising a rating (3.7 of the IOSCO Code Fundamentals)

The ratings assigned by credit rating agencies are often capable of exerting significant effect on the prices of the securities of the issuer concerned.

To ensure that the market operates effectively and to guarantee the quality and fairness of the ratings, the rating process *in all circumstances* should permit real dialogue between rating agencies and issuers, and presentation of the ratings analyses / reports to the issuer *prior to issuing or revising a rating* (and not only "where feasible and appropriate", as set out in provision 3.7 of the IOSCO Code Fundamentals), thus enabling issuers *to check in particular that any factual statements are correct.*

This is particularly necessary due to the small number of agencies.

Publication of ratings (3.1 of the IOSCO Code Fundamentals)

It is desirable to clarify the circumstances in which the publication of ratings decisions should or could be avoided and state that notification in a timely manner does not mean the immediate notification of decisions taken by agencies.

The quality of the ratings and of the dialogue must be a priority and must not be sacrificed to time constraints in the publication of ratings, as issuers are already under an obligation to publish, as soon as possible, certain information that concerns them directly if this information is likely to have a significant effect on the prices of their securities ("ongoing disclosure obligation").

Although we understand the principle according to which "the CRA should distribute in a timely manner its ratings decisions" (Provision 3.1 of the IOSCO Code Fundamentals), it is nonetheless important that its publications do not unduly disrupt the securities market. This could be the case in particular prior to the publication of accounts by the issuer, if the issuer

has no intention of proceeding with an issue, or indeed has even promised the agency that it will not proceed with an issue. Moreover *ratings should not be published during "black' or "quiet" periods.*

Feedback (Performance of the ratings) (3.8 of the IOSCO Code Fundamentals)

Provision 3.8 provides that "in order to promote transparency and to enable the market to best judge the performance of the ratings, the CRA, where possible, should publish sufficient information about the historical default rates of CRA rating categories and whether the default rates of these categories have changed over time (…)"

We feel that this information is useful and that its publication should not be conditional on feasibility; the expression "where possible" should therefore be removed.

Furthermore, we believe that this information could be enriched by other quality indicators enabling the market to judge the distribution and the levels of the ratings over a recent period (over the last 3 years for example), their volatility (jumps of more than 2 notches over a preset period, for example), and so on.

Access to and use of non-public information

Taking into account the responsibilities incumbent upon issuers for disclosure of information - in particular under the Market Abuse Directive - and the duty of confidentiality of agencies, we feel that credit rating agencies should not be required, or permitted, to disclose or disseminate non-public information given to them by issuers, as well as inside *or similar* information that issuers themselves have not disclosed. To avoid unduly disrupting the securities market and harming the issuer's interests, the issuer should be given a right to check that no confidential information is inadvertently disclosed by the credit rating agency, rather than disclose itself an imminent rating change, where the rating announcement would amount to disclosing such information.

Also it should be explicit that the issuer is under no obligation to provide inside information to a third party, e.g. a credit rating agency, and that, had a third party access to such information, it would be subject to the provisions relating to insider dealing.

Prior formalisation of the relations between agencies and issuers

While in favour of the implementation of codes of conduct, we nonetheless believe that such codes are unable to regulate all the specific relations between credit rating agencies and issuers.

However, we do believe that the codes of conduct should mention that, when ratings are drawn up at the request of an issuer, a contract is established between the credit rating agency and the issuer and that this contract specifies, *in particular***,** the following elements:

- The nature and purpose of the service or services ;

- The timetable of intervention or, where relevant (for ratings other than "point in time" ratings), interventions;
- Where relevant, the duration of the period of service, the precise purpose of the surveillance carried out by the agency following the initial rating and the conditions under which the ratings are revised;
- The total cost and the terms and conditions of payment for the service;
- The duty of confidentiality and the conditions of access to and use of non-public or similar information.

Revising ratings at least once a year for ratings other than point in time ratings (1.9 & 1.10 of the IOSCO Code Fundamentals)

Provision 1.9 provides that, for ratings that clearly indicate they do not entail ongoing surveillance, the agency should monitor and update the rating by regularly reviewing the issuer's creditworthiness.

In such case, we believe that a complete review should be carried out at least once a year by the rating agency in liaison with the issuer.

Also in order to ensure that the market is kept fully informed, it is important that the agency gives the date of full review of the rating, whereas provision 3.3 of the IOSCO Code Fundamentals provides only for the publication of the date the rating was last updated.

Right of appeal by the issuer to the agency

When differences exist between the issuer and the agency at the conclusion of the formulation phase of the draft report, it is essential that the issuer has a right of appeal to the agency, which should be able to be exercised before publication of the rating decision (see our response to question 7 above under section III Relationship between issuers and rating agencies).
The existence of such a procedure is likely to clarify the decision-making processes followed by agencies and hence to enhance the quality of information given to the market. In this context, the issuer must have access to an agency committee consisting of persons other than those who took part in the rating process. The issuer must have 24 hours in which to appeal and, in such case, the rating report must not be published before expiry of a 3 day period starting from the appeal date.

5. **To what extent is a joint treatment of rating agencies by banking and securities regulators desirable ?**

No comment