

Federation of German Industries - 11053 Berlin, Germany

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General Economic Policy

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BDI comments on the day-to-day application of the Credit Rating Agencies (CRAs) Codes of Conduct

Dear Mr Demarigny,

We would like to thank you for giving us the opportunity to present our views on the day-to-day application of the Code of Conduct for Rating Agencies. During the past few years the BDI in its capacity as the umbrella association of German industries was intensively involved in the debate on possibly regulating the agencies' activities. We expressed our expectations to the rating agencies both in various statements of opinion and at hearings and also put forward relevant proposals.

The Code published by the IOSCO in December 2004 envisages inter alia that rating agencies should inform issuers how the credit ratings are assessed. They should also inform issuers of every important change to their methodologies and procedures prior to their implementation. The agencies are required to take issuers' counter-arguments into adequate account before publishing ratings. The Code also contains regulations which ensure the independence of rating agencies, prevent conflicts of interest and should improve the quality of the rating procedure. Overall, these principles meet the expectations of the BDI and German industry.

It is also true that rating agencies are not legally bound to implement the Code. However, all leading agencies have published their own codes on a voluntary basis. We have previously called for a market economy enforcement approach. If the procedure does not prove successful, formal regulatory steps should not be excluded. However, first of all the implementation of the Code should be monitored. We have always rejected special European regulations. Cumbersome bureaucratic structures and inappropriate costs for issuers and investors must be avoided.

As requested we have forwarded the questionnaire you sent to our member companies. We are enclosing answers based on the feedback we received.

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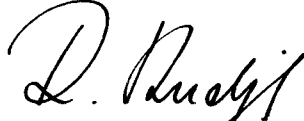
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At present it would certainly be too early to draw final conclusions. Nevertheless, we have indications from German industry that the situation has eased significantly. Issuers have consistently confirmed the adequate transparency, objectivity and independence of the rating agencies. We would like to expressly welcome this. In view of the situation today we see no grounds to depart from the previous procedure of self-regulation and do not see any need for immediate action.

We hope our experiences will help you in your further dealings with this issue.

Yours sincerely


Dr. Haß


Dr. Kudrins

Encl.

**Questionnaire on the day-to-day application
of the Credit Rating Agencies (CRAs) Codes of Conduct**

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

The most important issue – as far as quantitative methodologies are concerned – are the so called “adjustments” made by CRAs in order to compute credit metrics. It can be very difficult for a rated company to understand the CRAs’ calculation of ratios starting from published figures of the company. Some agencies are relatively active in explaining these adjustments. Others, for example, do not publish medians which enable an issuer to calculate the impact of alternative strategic options on the rating.

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

No, at the most this may be the case in unsolicited ratings.

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

In general, yes. But in some cases where rating reports which issuers receive prior to disclosure there may occasionally be discrepancies. The quality can be improved with sufficient resources.

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

Yes, as far as we are able to judge this.

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

Yes. In general, the period of time during which the rating decisions, the rating reports and the updates are publicly available is sufficient. But it depends on the situation. CRAs sometimes ask for final confirmation of documents which they want to publish at very short notice. Sometimes issuers have only a few hours to review a rating report prior to its disclosure.

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

CRAs explain their motivation for a rating decision carefully.

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

In general, yes. But agencies vary greatly as far as the announcement of potential acquisitions is concerned. Some decide within a few days even if it is not certain that an acquisition will be realized. Others put the issuer on watch and do not make the final decision until the realization of the acquisition. Both methods have advantages and disadvantages.

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

No, analysts never give assurances or guarantees about the outcome of a rating committee meeting. Nevertheless, it is possible to discuss the probability of the results in advance.

8.1 Do you consider that the CRAs disclose clearly in the rating decision whether
a. the rating was not initiated at the issuers request?
b. the issuer has not participated in the rating process?

It is not always clear to the reader that a rating was not initiated at the issuer's request and that he has not participated in the rating process. It should be absolutely clear whether the rating was requested (and paid) by the issuer. Whether and to what extent the issuer is involved, also says something about the quality of the rating.

8.2 Is the abovementioned disclosure valuable for you?

Disclosure of non-participation of the issuer in the rating process is necessary both for investors and issuers alike.

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

No.

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

In general, CRAs cooperate very closely in advance. But there have been cases where it has not worked so perfectly.

One CRA recently refused to give an indication of the rating decision only one day before it was published. The agency refused to inform the issuer until the day it was published. This means an issuer is not given an opportunity to discuss and clarify critical issues between the CRA and the issuer before publication.

CRAs generally request insider information and want to be informed as early as possible. On the other hand, the issuer should also have (vice versa) the right and the opportunity to request early and upfront information on the rating decision.

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

No.

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

Yes.

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

No.

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

No. The Agencies generally have separate staff for fee questions.

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

No.

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

No.

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

No.

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

One CRA recently changed its rating methodology, i.e. the equity credit for hybrid instruments was reduced to 50 %. The change of methodology was set in place at very short notice – without any upfront information to the issuer. Despite the impact of the change in methodology on the credit metrics it was not mentioned as a reason when analyzing the leverage.

In general, however, cooperation between CRAs and issuers is excellent. Additional regulation of the CRAs' behaviour is neither necessary nor appropriate.