



Moody's Investors Service

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Committee of European Securities Regulators
11-13 avenue de Friedland
75008 Paris
France

Re: Moody's Response to CESR's Consultation Paper relating to CRAs Central Repository

Moody's Investors Service ("**MIS**") appreciates the opportunity to provide comments to the Committee of European Securities Regulators ("**CESR**") on its consultation paper (the "**Consultation Paper**") relating to the establishment of a central repository (the "**Repository**") for performance data of credit rating agencies ("**CRAs**"). We believe that effective dialogue between CESR, the market and CRAs will assist CESR in providing guidance for a Repository that meets legislative expectations pursuant to the draft Regulation for CRAs published by the Commission and approved by the European Parliament and the Council (the "**Regulation**") as well as proving an effective tool for market use.

In the annex to this letter I set out our responses to the specific questions posed in the Consultation Paper. I hope CESR will find these helpful in framing its guidance (questions are listed using the paragraph numbers in the Consultation Paper). Where constructive, I have also shared some thoughts on other matters referred to in the Consultation Paper. In particular MIS is concerned with two aspects of CESR's proposed guidance as summarised below.

- (i) MIS is unclear of the basis upon which CESR has adopted a retroactive interpretation of the Regulation. We do not believe that this interpretation is warranted by the Regulation and we are concerned that it could exceed the scope of the Regulation. We also query CESR's authority to render the Regulation retroactive without enabling primary legislation. Specifically, we believe that CESR's suggestion that data should be presented for each of the 10 years preceding the date of entry into force of the Regulation would undermine legal certainty and erode MIS's legitimate expectation relating to our obligations under EU law.

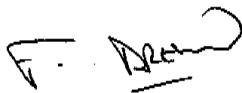
While we recognise that systems changes are likely following the entry into force of the Regulation, we have had no prior understanding that the requirements of the Regulation would be retroactive. If retroactive, it will not be possible for MIS to comply in some instances, as we will not have data

available in the requisite format. In other instances, we may have data available, but the burden involved in recalculating our performance on an annual basis for 10 years using criteria, definitions, geographies and codes imposed on a retroactive basis would be disproportionately heavy. We believe that, from its inception the Repository will provide users with the ability to compare between CRAs. Further, over time, the Repository will generate adequate year-on-year comparability between CRAs and between a CRA and its own historical performance. We would urge CESR to reconsider its retroactive interpretation.

- (ii) We have some concerns around how CESR intends the proposed minimal definition of default to operate in practice. As we discuss in more detail in our response, we do not believe that the proposed definition would achieve the degree of comparability between CRAs that is sought by CESR. If however, the definition is to be retained in CESR's guidance, we are concerned that CESR is suggesting that CRAs should calculate data according to two definitions of default – CESR's and the CRA's – in order that CRA's can differentiate between the two. To the extent that CESR retains its definition, we would urge CESR to clarify that qualitative analysis of the divergences between the CRA's definition of default and CESR's definition would suffice.

Once again, thank you for affording MIS the opportunity to comment. Please do not hesitate to contact me should you wish to discuss the contents of this letter in more detail and I welcome the opportunity to engage further with CESR during the course of the consultation.

Yours sincerely



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ANNEX

21. Do you agree with the suggested scope of the CRep?

MIS agrees with much of the suggested scope of the Repository. However, we do not agree with the geographical scope as set out in Paragraph 20 of the Consultation Paper.

At Paragraph 20 of the Consultation Paper, CESR suggests a three limb test for inclusion of ratings in the Repository; credit ratings that are “(i) issued or endorsed by credit rating agencies registered in the Community, (ii) issued by any certified credit rating agency or (iii) used for regulatory purposes in the EU and which are disclosed publicly or distributed by subscription”. We support CESR’s position that the scope of the Repository set out under Article 9 of the Regulation should not extend beyond the stated legislative scope of Article 2 of the Regulation, which relates to those CRAs that are registered in the EU and permits those entities enumerated at Article 4 to use only those ratings of registered CRAs for regulatory purposes. Consequently, MIS agrees with the first two subsets of the definition but disagrees with the inclusion of the third category for two reasons.

- (i) **MIS cannot determine which ratings would fall into the third category.**
MIS makes its ratings publicly available to all users via our web site. We have no control over or knowledge of how our ratings are used by issuers or investors. Importantly, we have no means of tracking which rating is used by which institution for regulatory purposes and whether that rating ceases to be used for regulatory purposes at any time.
- (ii) **Redundancy.** The third category of CESR’s test is already encapsulated within the first category, as a rating must be either issued or endorsed by a CRA registered in the Community in order for that rating to be eligible for regulatory use in the EU.

We suggest that the content of the Repository is limited to those ratings identified in the first two subsets of CESR’s definition at Paragraph 20 of the Consultation Paper and the third category is deleted. We believe that this should capture those ratings that fall into the third sub-set and should also allow meaningful data sets from which the market and CESR can analyse CRA performance.

50. Do you agree with this definition and limitation on the data to be reported?

We agree with most of the data items included in the Repository but have the following concerns.

- (i) **Additional Default Data.** We agree that information on past rating activities should be limited to those ratings that are used for historical performance statistics. However, CESR suggests that CRAs could consider providing “specific information relating to their assessment of rated entities’ ability to meet financial commitments or of the expected default rates within their particular rating scale so that investors can compare different rating scales using a common tool.”¹

¹ See paragraph 42 of the Consultation Paper.

We are unclear what CESR intends by way of specific information beyond the information that is contained in the rating. However, we would note that MIS's ratings are relative measures of credit risk (ordinal rather than cardinal measures) and that MIS expects that rating defaults and consequent losses will vary through the credit cycle. That is to say, our ratings do not "translate" to any specific expected loss number or anticipated default rate. It follows that MIS's ratings do not target quantitative measures of loss given default in each rating category. Rather, MIS's rating system expects that those credits ranked higher in the rating scale, in the aggregate, will have a lower expected loss than those ranked lower in the rating scale. The statistics that MIS publishes are averages of the loss rates that have been experienced historically and should not be used by the market to infer quantitative future target loss rates in any rating category. For these reasons, we do not believe that MIS can, or should, provide expected loss or default rates for rating categories within the rating scale.

- (ii) **CEBS' Mapping.** We also note that CESR suggests the inclusion of hyperlinks to CEBS' mapping of different rating scales of registered external credit assessment institutions ("ECAIs").² It is unclear to MIS who would provide this hyperlink. We do not believe that it would be appropriate for MIS to provide the hyperlink because we would not want to implicitly or explicitly endorse the mapping process that is outlined by CEBS. We do not participate in that process and have no knowledge of the methodologies used by CEBS to reach its conclusions.
- (iii) **Rating Scales.** Finally, we agree with CESR that the use of different rating scales by different CRAs should not be discouraged or prohibited. As CESR notes, there is great familiarisation among market users of ratings with the scales that are currently employed.³ Furthermore, it is critical that CRAs are not prevented from innovating and competing in a dynamic manner by enhancing the information content of their rating scales.

67. Are the given data requirements and time periods appropriate? In structured finance, it appears in some cases that the data required to track material impairments or defaults is not reported on a systemic basis and not reported or tracked on an electronic basis. Thus, would it be reasonable to set the reference date for reporting structured finance defaults or material impairments to one reporting period earlier than the reference date for the other segments (possibly to report 6 months delayed)? Are CRAs able to provide historical information for the period before entry-into-force of the Regulation in the granularity presented in this CP? If no, which minimum (top-level) information could be provided?

The data requirements are appropriate in many instances, however, we have highlighted below those areas where we have some concerns.

- (i) **Historical Data.** We note that CESR has suggested at Paragraph 66 that all data should be provided in the form set out in the Consultation Paper for each of the 10 years preceding the entry into force of the Regulation. MIS is concerned that CESR has adopted an interpretation of certain provisions of the

² *Ibid*, Paragraph 43.

³ *Ibid*, Paragraph 41.

Regulation that is retroactive in nature, which we do not believe is either explicitly or implicitly warranted by the Regulation. We believe that such a retroactive interpretation is inappropriate for the reasons outlined below.

- a. Guidance inappropriately exceeds the scope of the Regulation. We refer CESR to Article 40 of the Regulation⁴ which states that an existing CRA operating in the EU that intends to apply for registration under the Regulation “*shall adopt all necessary measures to comply with its provisions by [nine months after entry into force of this Regulation].*” By requesting data in the Guidance that predate the entry into force of the Regulation, arguably CESR has adopted a retroactive interpretation of the Regulation which exceeds the scope of the Regulation. We do not believe that this interpretation is an inappropriate extension of CESR’s authority and query whether this burden can be created through CESR guidance in the absence of an enabling clause in primary legislation.
- b. Legal certainty and legitimate expectation. Importantly, a retroactive application of the Regulation that requires MIS to comply with the text of EU legislation prior to its entry into force would undermine principles of European law relating to legal certainty and the protection of legitimate expectation.⁵ MIS believes that, absent extraordinary circumstances, the principle of legal certainty should provide market participants, such as MIS, with confidence that European legislation should not take effect from a point in time prior to its publication.⁶ Further, MIS should be able to rely on the corollary principle of protection of a legitimate expectation provided it has operated in accordance with the legal obligations to which it was subject at that time.

MIS has operated with a legitimate expectation that data could be tracked, analysed and presented in accordance with our own methodologies for assessing our performance. On that basis we have invested considerable time and capital in developing resources and systems that track data we deem to be relevant to this analysis. The effect of CESR’s suggestion in paragraph 66 of the Consultation Paper is to undermine this expectation by requiring us to present data retroactively in accordance with newly defined criteria, geographies, codes and definitions in a manner that diverges from our existing practices. Although we recognise that our systems may need to be adapted to cater for future legislative initiatives, we do not believe it is appropriate that they should also have to cater for retrospective changes that could not have been foreseen by MIS.

- c. Impossible for MIS to provide the information on a retroactive basis: MIS agrees with many of the requirements for information that CESR has specified in the Consultation Paper. In some instances, however, we will

⁴ In this response we refer to the text of the Regulation dated 14 July 2009 and adopted by the Council on 23 July 2009.

⁵ Both principles have been upheld by the ECJ as “superior rules of law” (See 74/75 CNTA (1975) ECR 533, exp 548 – 550 Paras 28 and 44), generally being accorded priority status over other legal instruments including Regulations.

⁶ See Case 108/81 Amylum v Council.

be unable to provide CESR with the information that has been requested for a time period prior to the date of our required compliance with the Regulation. As CESR is aware, to date, MIS has not been subject to formal regulation in the EU and consequently, in certain areas, MIS will need to adapt its business operations in order to become compliant with the EU Regulation. As discussed above, MIS's historical performance data has been tracked in accordance with our methodologies that underpin our existing published performance studies. It is likely, therefore, that there will be many cases where we will not have the requisite information available in our systems to recalculate our performance history in accordance with the requirements of the Consultation Paper. Throughout this response we have identified those areas where MIS may not have reliable historical information available in the form and with the requisite degree of granularity to provide CESR with the retrospective data it requests.

- d. Inappropriate burden of excessive data requests: We do not believe that a retrospective approach is warranted to facilitate comparability for users of our ratings. As CESR is aware, a draft version of the Regulation as agreed to in principle by the Council and voted upon by the European Parliament was published in April 2009. Prior to that date, CRAs could not consider modifying their businesses or systems until the requirements of the Regulation had crystallised in a manner that would allow full consideration of the obligations the text creates. Practically speaking, MIS could not have been aware of future dated obligations and could not have orchestrated our data systems and analysis accordingly. Applying a retroactive interpretation that requests data to be recalculated in accordance with newly established criteria and definitions creates an unanticipated burden for MIS. In most instances this exercise would prove very burdensome and costly to undertake for each of the 10 years prior to entry into force of the Regulation and we do not believe that we should bear the burden of re-engineering our systems to comply with those obligations retrospectively.

Importantly, we do not believe that creating a lengthy history prior to the effective date of the Regulation is necessary to facilitate ratings comparison. Following implementation of the Regulation, users may access performance data in the Repository, where it will be presented in accordance with the requirements of the Regulation and CESR's guidance. From its inception the Repository will provide a single source of information for users that seek to compare CRA's ratings. Over time, it will provide a valuable source of information from both existing and prospective CRAs with data from each year being comparable to the preceding years. In addition, users of our ratings may continue to access our published performance data on our website that will present data in a different, but no less valid, manner that will be directly comparable to historical studies produced by MIS. In this manner users of our ratings will be enabled to review and compare public performance data in two different modes.

Finally, we would note that the data request for information for each of the last 10 years could be prejudicial to existing CRAs when compared with the requirements for new CRAs to present data after one year.

- (ii) **Rating Withdrawals.** CESR has suggested that CRAs distinguish the reason for a rating withdrawal according to two broad categories; whether some external event caused the rating to become obsolete (e.g. a merger) or whether the issuer ceased to cooperate with the CRA.⁷ MIS has four concerns with this proposal as outlined below.
- a. Although, we defer to users of the Repository, we do not believe that the aggregate number of withdrawn ratings during a given period would provide any valuable information that would benefit the users of the Repository. The vast majority of MIS's ratings across all franchises are withdrawn upon the maturation of the debt, whether it is repaid or refinanced. We believe that identifying each instance of withdrawal in these circumstances would prove very burdensome and costly from a systems perspective without providing useful information to the users of our ratings.
 - b. The first category identified (e.g. merger) is unlikely to be applicable to structured finance securities and although, theoretically, the second category could apply it is not likely to be relevant in many instances. This means that reporting data for structured finance likely will be limited.
 - c. The two categories suggested by CESR may not allow sufficient flexibility to encompass possible situations for a rating withdrawal. For example, we are unclear how we should treat a rating that was withdrawn where an issuer requested the withdrawal of the rating and the CRA agreed. To the extent that CESR disagrees with our assessment that the aggregate number of rating withdrawals is not a valuable information point for users, we believe that MIS should be able to report according to the four categories of withdrawal that we have identified as being most relevant and which we currently disclose in the press release relating to the withdrawal. These categories are: 1) inadequate information, 2) bankruptcy or reorganisation, 3) business reasons and 4) maturity of the debt obligation.
 - d. MIS does not currently track the reason for a withdrawal of a rating in our performance statistics or on our systems and, therefore, we would not be able to provide this information on a 10 year historical basis as suggested by Paragraph 66 of the Consultation Paper.
- (iii) **Segmentation - US Municipalities.** We agree broadly with the suggested segmentation between corporate, sovereign and public finance ratings and structured finance ratings set out at paragraph 53 of the Consultation Paper. We would suggest, however, that US municipal securities could be treated as a discrete segment as:

⁷ *Ibid* Paragraph 52.

- a. the number of rated US municipal issuers and issuances is very large and their performance, therefore, would overwhelm any potential differences in the performance of the sovereign and non-US sub-sovereign sectors if combined in one dataset; and
- b. historically, MIS's US municipal ratings have been based on a different rating scale than sovereign and non-US sub-sovereign ratings.

MIS would also note that we have not maintained detailed historical data for U.S. municipal securities and we may not be able to report meaningfully for this sector on an historical basis over 10 years as requested by Paragraph 66 of the Consultation Paper.

- (iv) **Time Periods.** We are unclear what CESR means by providing information for the most recent 20 and 30 year periods as set out in Paragraph 63 of the Consultation Paper. We understood from paragraph 66 that historical performance covering 10 years prior to entry into force of the Regulation is suggested.
- (v) **Reporting Reference Dates.** We do not object to the proposed semi-annual reporting of performance statistics. However, due to data constraints, the suggested two month time lag following the semi-annual reporting date would be problematic in all sectors.

We believe that CRAs should be afforded an opportunity to be confident that the data to be published is appropriate and in order. For example, in structured finance, the data required to track material impairments is not reported on a systematic basis and not reported or tracked on an electronic basis. Accordingly, an assessment of which securities have suffered material impairments requires MIS to:

- a. conduct a manual exercise, extrapolating data from trustee reports that are often only available in PDF format;
- b. upload the data in an electronic form; and
- c. determine whether or not a material impairment has occurred or whether the potential impairment was subsequently resolved. This final element means that a security that is materially impaired may subsequently commence paying investors and no longer be deemed to be materially impaired. Therefore, the concept of whether a security suffers a material impairment is not static and requires MIS to refresh data to ascertain whether or not a missed payment of either principal or interest manifests in an actual loss as at the relevant reporting date.

Consequently, we suggest that although CRAs could report on a semi-annual basis, the appropriate reference date for reporting of structured finance defaults or material impairments could be the reference date 6 months earlier than the reference date for other business segments. This approach would allow an 8 month time lag between the reference date and the reporting date for this sector only and would facilitate CRAs posting meaningful and appropriate data in the Repository. For all other sectors, we believe that the

appropriate time lag between the reference date and the reporting date should be 4 months rather than the 2 month time period suggested by CESR.

86. Do you agree with the suggested differentiation of subsidiary ratings or would it make sense not to differentiate subsidiary ratings?

We address our response to the question at Paragraph 86 at (i) below. In subsequent point, we have raised additional observations in relation to other aspects of sections A4 and B of the Consultation Paper.

- (i) **Subsidiary Ratings.** We do not agree with the suggested differentiation of subsidiary ratings for the reasons outlined below and instead suggest that it would make sense not to differentiate subsidiary ratings.
- a. Paragraphs 84 and 85 of the Consultation Paper assume that subsidiaries can be treated in a binary fashion – either they are autonomous or they are not. In MIS’s experience this determination is highly subjective. For example, it is unclear how ratings belonging to the same corporate group would be treated upon the occurrence of a corporate event that results in a merger, a takeover or a spin-off. We believe that as a result of this inherent subjectivity the comparability across CRAs sought by the proposed approach would not eventuate.
 - b. MIS currently calculates its performance statistics using a senior unsecured rating that is assigned to each legal entity that issues rated debt, irrespective of whether or not it is a subsidiary and irrespective of its position in any corporate infrastructure. MIS does not currently track and has not tracked historically whether or not a subsidiary is autonomous. Similarly, MIS does not track and historically has not tracked corporate family relationships - which are often very different from those that prevail today. The effect is that MIS could not re-compute historical information in the manner suggested by CESR over a 10 year historical period.⁸ In turn, this means that our future performance statistics as posted in the Repository would not be comparable with our historic published statistics on our website.
- (ii) **Definition of Default.** We note that CESR states at paragraph 73 of the Consultation Paper that minimum conditions could be used to generate a standard definition of default in combination with a requirement that CRAs describe their own definition of defaults, how they diverge from the standard and the consequences thereof for the CRA’s default studies.
- Although we support effective disclosure of a CRA’s of its own definition of default, we have two concerns with CESR’s proposal.
- a. MIS recognises that differences in definitions can impact upon comparability, nonetheless, we do not believe that, in practice, a common definition of default would achieve meaningful standardisation across CRAs – we have provided our rationale in more detail below.
 - b. To the extent that CESR disagrees with MIS and believes there is value in a standard definition, we are unclear what CESR intends by a disclosure of

⁸ *Ibid*, Paragraph 66.

the consequences or implications of divergence of the CRA's definition of default from the standard minimal definition. In particular, we are concerned that this would require CRAs to present data performance in accordance with their own definitions and also in accordance with the common definition, in order to ascertain the divergences and the implications of those divergences.

The problems with such an interpretation are three fold.

- i. It would prove very burdensome and we believe that MIS would have difficulty in tracking and computing data on the premise of each definition within the requisite time periods suggested by CESR.
- ii. Importantly, MIS will not always have the requisite data that would be required in order to re-compute our historical statistics in accordance with this definition over a 10 year period. In particular, in structured finance, it may not be possible across all asset classes on a consistent basis to the extent that there are not appropriate records in existence.
- iii. In those circumstances where we may have data available, recalculation of historical performance according to a different definition would involve an even more significant time and huge cost investment. As noted above, we do not believe that the suggested common definition will increase the degree of standardisation in a meaningful way. As a result the burden incurred by CRAs would be disproportionate to any minimal benefit conferred on users of ratings.

To the extent that CESR disagrees with MIS and believes there is value in the concept of a minimal definition, we suggest that CESR clarify that qualitative disclosure on the part of the CRA to indicate where it anticipates divergences between its definition and any minimal definition would be appropriate.

Why minimal definition may not achieve comparability.

We have evaluated MIS's structured finance ratings and fundamental ratings separately.

Fundamental

Differences in Implementation of the Definition. Despite elements of commonality in the definition of default among CRAs, the subjective nature of certain aspects is likely to result in meaningful differences being exhibited by each CRA upon implementation of the definition. In turn, this is likely to erode the commonality that CESR seeks to achieve through a more standardised definition. For example, divergences of approach could arise under the common definition suggested by CESR in the following situations.

- a. When does a default arise? Determination of when non-payment of interest or principal constitutes a default is subjective. By way of example, some CRAs will factor in grace periods prior to determining that a security has defaulted, whereas others will

determine that a single missed interest payment meets the threshold level for default.

- b. What constitutes maturity? Elements such as a determination of “maturity” are open to interpretation by each CRA. For example, “maturity” could mean final maturity of the security, the expected maturity, each interest payment date or the legal final maturity. Each scenario would result in a default being declared at a different time and reported on a different basis.
- c. What constitutes a debt restructuring? Although many CRAs may consider debt restructuring as an element of default, the determination of what constitutes a debt restructuring is inherently subjective and likely will differ from CRA to CRA. For example certain CRAs will require a minimum threshold amount of debt to be restructured before the classification is triggered. Others will look at the intended purpose of the restructuring and assess whether or not it was intended for the purposes of avoiding default, while still others make their determination based on the rating the CRA assigned to the issuer prior to the debt-exchange.

Structured Finance

We would note that we do not believe that the three conditions identified at paragraph 72 of the Consultation Paper are the most conducive to creating a common definition of default in structured finance – we discuss this in more detail below.

- a. Material Impairment vs. Default. The elements outlined in the common definition are used by MIS in its fundamental ratings sector. However, in the structured finance sector, MIS uses the concept of a “material impairment” rather than a “default”, in recognition of the significant differences in the definition of default and expected loss between the corporate and structured finance sectors.⁹

⁹ See “*Payment Defaults and Material Impairments of U.S. Structured Finance Securities: 1993-2002*,” December 2003” MIS Special Comment, December 2003.

Defining payment default prior to the final maturity date can be complicated. Each securitisation’s prospectus generally provides a technical definition of default. Some prospectuses, however, anticipate that interest and principal due in a given period can under certain circumstances be deferred to later periods. Sometimes payment shortfalls are capitalised and hence one-time shortfalls can be made up to investors gradually over the remaining life of the transaction. Sometimes one-time shortfalls are due in full at the beginning of the next payment period. Sometimes payment deferrals require interest on interest, and sometimes they do not.

MIS’s structured ratings primarily address a security’s lifetime expected loss rate. As a result, ratings performance may not be inferred as well from defaults – which may or may not be cured before the final maturity date – as from material impairments, securities that are virtually certain to have accumulated permanent interest or principal losses on their final maturity date.

Some of MIS’s structured ratings also address the timeliness of payment. However, the definition of timeliness of payment varies not only from sector to sector and at time from transaction to transaction within sectors based on the explicit promises stated in the securitizations’ prospectuses.

MIS adopts a single definition of payment default that can be applied to all securities. This definition is based on payment shortfall information as recorded in periodic servicer reports, which

MIS defines structured finance securities as being in material impairment if they have suffered an interest shortfall or a principal write-down that remains outstanding at the end of the study period. Securities that were downgraded to Ca or C, even though they had not yet experienced interest shortfalls or principal losses, are also considered to have been materially impaired.

MIS believes that this is the most appropriate measure of whether a structured finance security has experienced impairment or is in distress and consequently, we suggest that CESR consider an alternative common denominator for structured finance securities that contemplates material impairment or its equivalent. At a minimum, we recommend that any common definition contemplates a consideration of principal write down as an indicator of default. Moreover, we believe that CESR should suggest to the market that all missed interest (irrespective of whether or not it is capitalised or whether "payment-in-kind" is substituted for cash) should be classified by a CRA as a default or material impairment. In those circumstances, missed interest payments that are subsequently "cured" or repaid should be removed retroactively from the default or material impairment category.

- b. Absence of Relevance. Elements of the common definition would not appear to be as relevant for structured finance as they may be

are commonly available to investors. In some cases, this definition does not conform to the definition of timely payment specifically addressed by MIS's rating or to the concept of default explicitly defined in the deal underlying documentation of certain transactions.

Even for securitisations that allow for the deferral of promised interest and principal, many investors have a reasonable expectation of timely payment of interest. The definition of default used in this study identifies the initial date of default as the first payment period (typically first month) in which investors receive less than they would be entitled if the assets underlying the transaction had performed well from a credit perspective. If these shortfalls continue unabated for many months, the security will clearly suffer payment shortfalls and default at its final maturity date. However, any effort to be more precise than for many months would be quite arbitrary.

A structured security is therefore defined as being in payment default if it has suffered:

- an interest shortfall (excluding prepayment interest shortfalls), or
- a principal write-down.

Payment default rates, however, may be poor proxies for expected loss rates, both because many payment defaults will be eventually cured and will not impose permanent losses and because securitizations often experience sufficiently poor collateral performance that losses at final maturity are certain even though no payment shortfalls have not yet materialised.

In the former case, MIS may in fact maintain a high rating on a security in default during the security's cure period. In the latter case, MIS will generally assign a low rating despite the absence of a current default. For example, securities rated in the two lowest rating categories, Ca and C, are virtually certain to sustain substantial losses at maturity even if they are not yet in default. For these reasons, we define a security to be materially impaired if it has:

- sustained a payment default that has not been cured, or
- been rated Ca or C and hence is expected to suffer a significant level of payment losses in the future.

for fundamental ratings. For example, as structured finance issuers are created to be bankruptcy-remote vehicles, situations such as bankruptcy or administration are likely to be less relevant (although not impossible). Similarly, debt restructurings of structured finance securities occur on a much less frequent basis than those of fundamental securities.

- (ii) **Unsolicited Ratings.** We agree with the inclusion of unsolicited ratings in the data base for future performance information, but we would note that, historically, MIS has not segregated its unsolicited ratings that it has issued in the past in its data base. MIS has evaluated the performance of all of its ratings irrespective of whether they have been solicited or unsolicited. Consequently, we could not provide historical information over 10 years on the performance of unsolicited ratings as a discrete class of securities. Finally, in the interests of transparency, we believe that each CRA should disclose publicly its definition of unsolicited ratings.
- (iii) **Industry Segmentation.** MIS has not used the suggested industry segmentation in order to report our historic performance data. Consequently, we believe that changing our systems would impair the comparability of our past performance data to future data posted in the Repository. MIS believes that continued use of existing coding in our data bases coupled with a qualitative description of how the coding operates would be more effective to generate comparability for users of the Repository.

88. Do you agree with the proposed breakdown into issuer (long-term) ratings and short-term ratings? Would you prefer additional types of credit ratings to be include in the CRep?

We agree with the use of issuer ratings (long-term debt ratings or senior unsecured ratings, although we would note that these two constructs are not always directly comparable) and short-term ratings (or similar).

96. Do you agree with the provided segments.

We do not object to the proposed geographic breakdown for sovereign and public finance ratings for future reporting of ratings performance in the Repository. If CESR determines that EU registered CRAs must disclose all ratings produced by non-registered subsidiaries in the same international group, then we suggest that it might be practical to treat U.S. municipality securities as a separate category, as (i) their enormous volume would obscure data relating to sub-sovereigns and (ii) they have traditionally been evaluated using a different rating scale.

We would also draw CESR's attention to the fact that, historically, MIS has not tracked information on the basis proposed by CESR and to do so would be very burdensome.

105. Do you agree with the provided criteria used to define the region of issue?

- (i) **Domicile of the assets.** We do not object to the use of the domicile of the majority of the underlying assets as the primary variable to define the region of the issue. However, as CESR recognises, this will not always be determinable in certain asset classes, e.g., CDOs, and a secondary variable may be required. In these circumstances, we do not believe that the domicile of the relative majority will provide sufficient clarity. For example, there are likely to be transactions where the domicile of the assets may not be well defined or where the manager has discretion to alter the composition of the portfolio on a dynamic basis and thus change the geographic concentrations from time to time. Further, there may be circumstances where there is no relative majority as the assets may be evenly dispersed across geographies.

In those instances where the domicile of the majority of the underlying assets is not available, and at a minimum for CDOs, we suggest that each CRA should determine its own metric and disclose this. MIS, for example, would determine the jurisdiction by virtue of where the appropriate monitoring analyst is located as this provides clarity and certainty.

Finally we would note that it would be difficult for us to re-present data for an historical ten year period on the basis of this definition as the requisite information may not have been tracked by our systems on a systematic basis.

- (ii) **Foreign currency and local currency ratings.** CESR notes that many CRAs assign both foreign and local currency ratings to sovereign debt instruments and suggests the inclusion of both ratings in the Repository. At present, MIS uses the lower of the two ratings for our performance statistics and we do not believe that the inclusion of both ratings is most appropriate for the following reasons:

- a. MIS utilises an issuer-weighted methodology to assess our performance; either the issuer defaults or it does not. We understand from the Consultation Paper that CESR agrees with this broad approach. In order to employ this methodology consistently, it would be most appropriate to track the lowest of either the foreign currency or the local currency rating as this would provide the user with information regarding the debt that is most likely to default.
- b. Importantly, MIS has observed that due to increased globalisation of the financial markets there is a tendency for the local currency and foreign currency ratings of the majority of sovereigns to be aligned. Increasingly, there is a convergence of the probability of default associated with both ratings, with sovereign defaults occurring on both local currency and foreign currency ratings. This is a trend that we anticipate will continue. Accordingly, we expect that reporting both ratings will provide limited if any value in the future.
- c. Finally, MIS's local currency ratings have only been existence since 1997 and hence our ability to provide meaningful historical data would be limited.

108. Do you agree with the proposed definition of asset classes?

MIS would make the following suggestions to the proposed definition of asset classes which we believe may be more user-friendly for users of the Repository.

- (i) MIS believes that home equity loans or HEL would be better grouped in the RMBS sector rather than in the standard ABS sector.
- (ii) We do not believe that the grouping of auto/boat and airplane loan backed securities is most appropriate as auto loan securities display different characteristics to the others. MIS would suggest instead that auto loan securities are treated as a distinct category and that boat and airplane securities fall within “other ABS”. Further, MIS is unclear whether securities backed by leases (whether auto, aircraft or other leases) would be considered loans for CESR’s purposes.
- (iii) MIS is unclear how commercial real estate CDOs would be treated. We believe that they are most appropriately classified within the CMBS sector.
- (iv) MIS does not currently segment our CDO categories in the manner suggested by CESR and we are not clear that the differentiation drawn between simple cash CDOs and synthetic CDOs is meaningful because it does not address the issue of what assets underpin the CDO whether they are loans, corporate bonds, structured finance securities or some other asset.

In order to enhance the functionality of the Repository for users, we suggest that CESR consider the following CDO categorisation:

- ABS CDOs
 - CLOs/ SME CLOs/ Balance Sheet CDOs
 - Cash flow/ hybrid CDOs (excluding ABS CDOs and CLOs)
 - Corporate synthetic CDOs
 - Market Value CDOs.
- (v) Finally, we believe that although it may be possible to provide data historically for 10 years in the manner suggested by CESR, it would prove very burdensome to do so and, in light of how data has been stored on our systems, we may not be able to assure CESR of the precision of the results.

112. Do you share the general idea of presenting information on rating activities for all CRAs irrespective of the number of assigned ratings (after being one full year in business)? Do you agree with the proposal to present information on rating performance only for prescribed minimum sample sizes? Which other ways could you envisage to ensure the statistical validity of information presented in the CRep?

We agree with CESR’s proposal to request historical ratings after a period of one year and for the minimum sample sizes suggested. We do not have further suggestions to ensure statistical validity of information in the Repository.

117. Do you agree with the scope of information presented in the table on rating activities? Do you agree with the method of calculating the number of upgrades/downgrades? Do you consider the conditional number of defaults, i.e. the number of defaults following a rating

outlook or credit watch to be useful information? Are there further information needs from a user's perspective?

We agree with the scope of much of the information in the table of rating activities and would make the following observations.

- (i) As indicated earlier, MIS does not employ “outlooks” in structured finance¹⁰ and consequently could not provide data on this sector as requested in the chart in Section B1.
- (ii) Please also note that in relation to structured finance, historical revisions to data may be required, for example, due to re-classifications of sectors. Consequently, it is MIS’s practice to refresh its data sets when it reports in order to reflect the most recent evolutions. We suggest that the data posted in the Repository are adjusted to allow for historical revisions.
- (iii) We are unclear what CESR means by the number of withdrawals or discontinuations at the beginning and end of the period as set out in chart in Section B1. We would suggest instead that only the aggregate number of withdrawals during the period is relevant.
- (iv) We agree with the method of calculating the number of upgrades/downgrades. We are not aware of further data that may be of benefit to a user.

123. Do you agree with the proposed minimum numbers of ratings for presenting data with respect to default rates, both at rating class and a notch level?

We do not object to the proposed minimum threshold levels suggested by CESR.

In paragraph 127 of the Consultation Paper, CESR suggests that cumulative default ratings should be presented for periods of [3], [5], [7], [10], [20] and [30] years both for the most recent period and for averages over these periods. MIS is unclear how this requirement would align with the requirement at Paragraph 66 of the Consultation Paper that requests data on an annual basis for 10 years prior to the entry into force of the Regulation. As noted above, MIS has concerns regarding our ability to report data in accordance with the requirements of the Consultation Paper over a 10 year period.

We would also note that MIS does not have material impairment data for structured finance over 20 or 30 years and so could not meet the requirements in this sector.

MIS is unclear what CESR means by the average over these periods as each CRA’s data covers different time periods. If each CRA uses different time periods to compute the average, it is likely that the information in the Repository will not be comparable among CRAs. Therefore, we suggest that the time periods refer to the “most recent” 3, 5, 7 and 10 year time periods only. Finally, MIS assumes that the most recent 10 year period refers to data commencing from 1 January 1999 until 31 December 2008.

128. Do you agree with the proposed minimum numbers of ratings for presenting data with respect to cumulative default rates, both at rating class and a notch level?

¹⁰ MIS produces “sector outlooks” which constitute an forward looking analysis of how MIS believes an entire sector will perform over the defined period. These do not pertain to specific ratings, but rather to the entire sector.

We do not object to the proposed minimum threshold levels suggested by CESR.

Please note that as discussed in our response to the question at paragraph 86 above, MIS's definition of material impairment is not static; it allows for missed payments to be "cured" and consequently securities may be reported as materially impaired but may subsequently no longer meet the definition. For this reason, MIS refreshes its data prior to reporting. To generate consistency with previously published studies on our website and in the interest of reporting "fresh" data, we suggest that the data posted by a CRA should allow for historical revisions that may have occurred.

133. Do you agree with the proposed minimum numbers of ratings for presenting data in a transition matrix, both at rating class and a notch level?

We do not object to the proposed minimum numbers of ratings suggested for presentation in a transition matrix. In the interests of transparency and to allow greater comparability, we would suggest that CRAs disclose their methodology for calculating transition matrices.

136. Do you agree with the proposed minimum number of defaults for calculating a Gini coefficient?

We do not object to the proposed minimum number of defaults.

141. Do you agree with the basic design principles for the CRep? Which further functions could you envisage regarding presentation and navigation? How should the output be designed to fit the needs of a user?

We agree with the basic design principles for the Repository and believe that CESR has suggested the inclusion of the most relevant functions.

144. Do you agree with the list of minimum information to be provided in the CRep? Which further information do you think of being indispensable to allow users of the CRep the correct interpretation of presented data?

We agree with the list of minimum information to be provided in the Repository. We believe that CESR has captured the most salient information for users but we defer to the actual users in this regard.