



COMPANHIA PORTUGUESA
DE RATING, S.A.

Ref.: CESR's Consultation Paper on CRAs Central Repository

Dear Sirs,

Having analysed CESR's Consultation Paper on CRAs Central Repository (the "Paper" from now on), and compared it to the corresponding pre-consultation paper, Companhia Portuguesa de Rating, S.A. (CPR) would like to comment on the following:

1) General Process: Reversed Rationale of the Process

CESR and the Commission have publicly established as objectives of the CRA Regulation, among others:

"to create incentives for the emergence of new CRAs in the market"

"to increase transparency by setting disclosure obligations"

"to improve the quality of the methodologies and the quality of ratings" and

to "contribute to investor's protection"

It is CPR's opinion that this rationale can be completely subverted with some of the proposals included in this Consultation Paper on CRAs Central Repository.

The objective of a CRAs Central Repository should be to have a homogeneous database capable of producing standardized and unbiased statistical data on rating activity that can be easily used by those who need such information.

It is useless and greatly misleading to have statistics that are not valid and which only favour the big CRAs, by excluding small CRAs from the CRAs Central Repository.

This will increase entrance barriers in the CRAs industry, avoiding competition from small CRAs and perpetuating the oligopoly that was one of the causes for the problems that happened with the big CRAs ratings during the present crisis. Both of these are against the European Union Treaty and against the previously mentioned objectives of the Regulation.

Being oriented to each CRA preparing its own output information, CPR considers that:

- CESR's proposals for CRAs Central Repository will be misleading, as statistics published through CESR's proposal will have no statistical / scientific validity and, as such, should not be used for any purpose;**



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- **CESR's proposals for CRAs Central Repository will not increase transparency by setting disclosure obligations, as only the big CRAs will be able to publish their statistics in the manner required by the Paper's proposals;**
- **through the prejudice of small CRAs (which better know and understand local realities of local ratings) CESR is contributing to reduced competition in the CRA industry and to the deterioration of the quality of the methodologies and the quality of ratings;**
- **it will be impossible to reach an homogeneous database if each one of the dozens of existing rating agencies computes its own statistics individually – even if CESR seeks to homogenise the procedures for doing so – not least because it is impossible to cover all the issues that arise in the computing of such statistics;**
- **all the above-mentioned consequences will contribute to investor's lack of protection.**

For all these reasons, in our opinion **the Paper's rationale should be reversed, i.e., CRAs should be asked to supply to CESR standardized inputs/data about the ratings issued, changed or withdrawn, and respective defaults, so that CESR may centrally compute this information, in a fully harmonised manner, into the statistics that may be considered relevant and statistically valid.**

This rationale, in opposition to that presented in the Paper, **will have the advantage to:**

- **avoid the anti-competition effect** of negative discrimination and exclusion of smaller (European) CRAs from the CRAs Central Repository and its consequences referred above;
- **avoid differentiated treatments from one CRA to another** (which even the attempt to standardize as much as possible data treatment will not prevent), therefore achieving much greater transparency in the final data / outputs;
- **achieve economies of scale in data treatment:** instead of dozens of entities doing the same statistical treatment of data, there will be only one institution doing it, CESR;
- **enable the breakdown of the information by criteria other than that of the rating agency** (for instance, permitting to know how many ratings were assigned to industrial companies in Spain by any rating agency), which will not be possible if the methodology proposed by CESR is followed;
- **enable the statistical relevance of default rates for certain breakdowns of ratings** for which even the large rating agencies will not have sufficient data (for instance, if one wants to know the default rates of short time ratings assigned to Portuguese companies, even all the data provided by CPR – which has issued the majority of such ratings – will not be statistically significant, while if these data can be put together with data provided by Standard and Poor's, Moody's and the Fitch Group in Portugal, the statistical significance will greatly increase);



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- **increase investor's protection, by providing useful and valid outputs.**

2) Segmentations

When any kind of segmentation is made of statistical data about rating, whether geographic, by industry, by market segment or other, the output loses statistical significance, because there is always and still the segmentation made by the rating scale, with or without notches.

Therefore, underlying the entire data treatment, it must always be taken into account that:

- one thing is to be able to do a detailed analysis and a very detailed breakdown of the absolute data (ratings issued, ratings changed, ratings withdrawn, etc.);
- and another thing is to be able to have a statistically significant analysis with respect to relative measures, such as default rates, cumulative default rates, transition rates in transition matrices or performance ratios.

Hence, and regardless of other comments about the possibilities of data segmentation (see further down) for the referred detailed analysis, it must be taken into account that a statistically significant analysis in terms of relative measures should involve as little breaking down as possible, as otherwise the final data will risk losing statistical relevance. For instance, for a transition matrix, including notches (which has something like 27 x 28 cells) to be statistically significant, a minimum of approximately 40 observations per cell would be required, which gives a minimum of approximately 30,240 observations. Even by rating classes, the base matrix would have to have a minimum of approximately 4,400 observations (10 x 11 cells matrix x a minimum of approximately 40 observations per cell). Any breakdown would multiply these figures by the number of breakdown possibilities (such as 5 geographical areas or 8 industries, for instance). No rating agency (not even Standard & Poor's) has a number of observations permitting to make such breakdowns and obtain statistical relevance.

Lowering the level to 50, 100 or 200 observations per rating agency or 25 defaults per rating agency during a time period (as is done in proposal of paragraphs 121., 122., 124., 126., 130., 131. and 135.) corresponds to having data completely useless, for it has no statistical meaning (and, as such should not be allowed to be used for any purpose), and could lead to very erroneous conclusions.

On the other hand, even these numbers of observations will not be reached by smaller CRAs, which would eliminate almost all compilation of data from these CRAs, thus conveying an (ill-conceived) notion about the incompetence of such agencies (even CPR, which is probably one of the European agencies with the largest statistical basis, if not the largest, has assigned a total of 393 short term ratings over its 21 years in business up to the end of 2008), while contributing, with statistically not



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significant data, to eliminate competition and perpetuate the existing situation of oligopoly in the sector.

In CPR's view, the only way to overcome these difficulties is to follow the above mentioned proposal of reversing the logic of the process of the Central Repository, asking CRAs to supply to CESR inputs/data about the ratings issued, changed or withdrawn, and respective defaults, so that CESR may centrally compute this information, adding information of all CRAs in a fully harmonised manner, into the statistics that may be considered relevant and statistically valid.

In any case, it is the opinion of CPR that, for the purpose of relative measures, to avoid losing statistical significance, segmentations should only be made between:

- short term ratings versus medium and long term ratings, because they are based on differentiated rating scales;
- debt or issuer ratings, on the one hand, and structured products ratings, on the other, because the methodologies underlying the two analysis are substantially different.

Actually, the principle underlying ratings is to provide an universal measure of a detailed credit risk, fully comparable, from the investor's standpoint, between different rating agencies and different issuers (whether a bank in the Popular Republic of China, a commercial company in Europe or a sovereign State in Latin America), and therefore the information that matters to the final investor is to know (through a statistically valid number, and not an invalid one) the probability of default or of a change in such measure, regardless of the rating agency that assigned it or the issuer that it concerns.

Hence the solution will be to aggregate data from various rating agencies when the objective is to obtain statistically relevant data about relative performance measures, with the possibility of, in certain cases, making some kind of breakdown by large classes: such as, for example, the financial sector (including banks and insurance companies) at world level, or all the companies in Europe.

3) Credibility of the Rating Activity: Unsolicited "Ratings" and Scorings Situations

CPR believes that **no form of unsolicited credit risk analysis, whether of scoring or of rating, should be considered in the CRAs Central Repository**, since such types of credit risk analysis are simplified and automated and/or lack access to all the information required to duly substantiate a definite opinion about credit risk, and in fact use methodologies that are substantially different from



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rating methodologies and only serve to provide an approximation to a rating opinion when, for one reason or another, one is not available.

Unsolicited “ratings” and scorings have their place and utility to investors or other counter parties in analysis of small and homogeneous sectors or as a rough approximation of (true) ratings, but **should not be allowed to be used as true credit ratings, unless we want to welcome problems similar to the recent ones in the credit rating of structured products** (another case of completely different ratings used as if they were traditional ones).

Just think about what would happen if one allows unsolicited “ratings” or credit scorings of Barclays, EDF, Telecom Italia, the Kingdom of Spain or Germany to be used as (true) ratings for regulations purposes, such as calculation of capital needs in the banking system!

4) Specific Comments to Specific Paragraphs and Questions of the Paper

Taking into account the general comments provided in 1), 2) and 3), we consider that on the whole the reply to each paragraph or question of the Paper loses relevance. Even so, we would like to make the following comments (numbered in accordance with the Paper’s paragraphs):

14. Although we agree that “there is no indication that the CRep might include individual credit ratings or rating withdrawals”, there is also no indication that the CRep might not include individual credit ratings or rating withdrawals.

21. As referred above, CPR completely disagrees with the suggested scope and organization of the CRep. In our opinion rating agencies should be asked to supply to CESR standardized inputs/data about the ratings issued, changed or withdrawn, and respective defaults, so that CESR may centrally compute this information, in a fully harmonised manner, into the statistics that may be considered relevant and statistically valid.

38. With the Paper’s proposal it will be impossible to “produce and disclose a minimum level of simple and unambiguous rating and performance metrics in a format that enables investors to compare the performance of different CRAs directly”. In fact, **if followed, the Paper’s proposal will produce and disclose false (as not statistically significant / valid) and ambiguous (as they will include data of very different realities – “true” credit rating and unsolicited “ratings”) rating and performance metrics which, if used by investors, will most probably lead to problems much more serious than the ones revealed in big CRAs during the present crisis and will not be useful for comparing the performance of different CRAs directly, as smaller CRAs will not be able to publish their statistics under the proposed rules.**



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40. to 43. The rating scales of rating agencies, although not completely homogeneous, are very directly comparable, and therefore, providing the rating agencies are registered with CESR, the mapping of the agencies' rating scales should be direct, which is actually what investors already do on an everyday basis.

53. We consider that, for a statistically significant analysis with respect to relative measures, there are no grounds for a segmentation between corporate and sovereign & public finance ratings, for the reasons given before (direct comparability between them), but only between debt or issuer ratings, on the one hand, and structured products, on the other. Nevertheless, CPR has no objection on such segmentation for the purpose of a fine analysis of historical absolute measures about ratings, as explained before.

74. CPR is deeply against mixing the so-called unsolicited "ratings" in rating statistics. CPR completely disagrees that "the process of issuing an unsolicited rating is no different to that for issuing an issuer-paid rating" and with the affirmation that "unsolicited ratings should match solicited ones in terms of quality". **How can the process of issuing an unsolicited "rating" be no different to that for issuing an issuer-paid rating, if the CRA does not have the collaboration of the issuer and, as such, the access to all the information needed to form its opinion? This is the essence of the credit rating: to overcome the asymmetry of information between the issuer and the investor! And how can, in these circumstances anyone assure that "unsolicited ratings match solicited ones in terms of quality"?** Isn't all this just wishful thinking of some parties issuing unsolicited "ratings" (which, by the way, have very important conflicts of interest with the activity of issuing credit ratings)? We fear that if this is done we will face in the future the same problem that occurred recently with the confusion between the meaning of ratings of structured products and that of debt or issuer ratings.

90. It is a clear and shameful example of the influence of the big (American) CRA on CESR's proposals the fact that an European Regulation establishes a geographic segmentation as "US" versus "Non-US"!

109. to 112., 123., 128., 133. and 136. In CPR's opinion, **the solution for having data for smaller CRAs should not come through lowering minimum sample sizes (and losing statistical significance of the outputs, making them useless), but through the proposed reversal of the logic of the process of the Central Repository**, as presented above, asking CRAs to supply to CESR standardized inputs/data about the ratings issued, changed or withdrawn, and respective defaults, so that CESR may centrally compute this information, in a fully harmonised manner, into the statistics that may be considered relevant and statistically valid.

117. If rating agencies started using outlooks for the ratings issued it was because they believed this added value to the ratings; outlooks may therefore be used as a further criterion for the segmentation, but, again, only for a fine analysis of historic absolute measures about ratings, as explained before.



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We shall be pleased to assist you in every way we can.

Yours faithfully,

José Poças Esteves

Pedro Braga da Cruz