August 24th, 2004

Mr. Fabrice Demarigny
Secretary General
The Committee of European Securities Regulators

RE: View on Call to CESR for Technical Advice on Possible Measures concerning Credit Rating Agencies

Dear Sir,

The CESR has call for all interested parties to submit views as to CESR should consider in its advice to the European Commission. I would like to take the time to respond to the request for views.

The CESR call for evidence points out that government agencies and outside organizations such as the European Parliament, International Organization of Securities Commissions (IOSCO), The United States Securities and Exchange Commission (SEC), the G8, the Organisation for Economic Co-operation and Development (OECD), the Association Française Des Trésoriers D'Entreprise (AFTE), The Association of Corporate Treasurers (ACT), and the Association for Financial Professionals (AFP) have either called for comments, adopted resolutions, and/or published statements concerning the roles and practices Credit Ratings Agencies (CRAs).

I have read the transcripts, testimonial records and other available information and have responded to the call for comments by the SEC, AFTE, ACT and AFP. I have also responded to some issues brought forth during U.S. Congressional hearings of the SEC in regards to CRAs. Furthermore, I am the founder of a company that has supplied services to the CRA industry's users for over a decade. Most of the various parties such as the ratings organizations, issuers, and corporate treasurers are well represented in these forums. However, I have found that the public at large (investors and other users of ratings information) and non-CRA vendors are not as well represented in these same forums. The following response is written from my professional experiences as a non-CRA vendor and as a member of the public at large. By cooperating and gathering information from all available and interested parties, much needed progress and changes can occur within the CRA industry. The following are the recommendations that I believe need to be made in order to bring a much needed healthy corrective change to the CRA marketplace.

Regulatory Recommendations

Because of the practices of current CRAs, I believe that most of the actions recommended must become part of a regulatory oversight and be made part of law. Both the SEC and the EU should enact laws that would regulate CRAs. Regulators should:

1. Eliminate regulatory burdens and barriers to entry of becoming a CRA. In order to do these, regulators should establish and clearly communicate simple, stringent but attainable criteria that CRAs must meet in order to be recognized or approved. Regulators should also clearly establish procedures, steps, reviews, appeal processes and timelines that potential CRAs can rely upon as a guide to becoming a CRA. The SEC has not provided clear criteria, guides, timelines or even acknowledged potential NRSROs in the U.S. As such, potential NRSROs have no insight into how long it will take, where they are lacking in respect to becoming a NRSRO, the approval process, hearings, appeals or others. This was shown quite clearly in the hearings held by the SEC in November 2002.
2. In the last decade there has been a consolidation of the number of CRAs thus reducing competition. In the U.S. the number of NRSROs has been reduced from 7 in 1991 to 3 by 2002[1]. To become a successful and accepted CRA a candidate company has to make a large capital investment, incur multiple years of losses and battle CRAs that have monopolistic power and act in anti-competitive means before even becoming a marginally accepted and profitable CRA. Currently two NRSROs, Moody's and S&P, control a hugely disproportionate portion of the worldwide ratings market. Furthermore, both of these NRSROs enjoy the sanctity of the NRSRO designation while not being regulated and state that they are protected under their first amendment rights[2]. Both are using the cover of NRSRO designation and first amendment rights as what appears to be a way of keeping competition out of the marketplace. This has allowed their profit margins to be unrealistically high as compared to a thriving, competitive market. In order to allow competition and a healthy market to develop the following should be undertaken by regulatory agencies, especially by the EU and the SEC:
    2.1. Regulate the CRAs. In the U.S. the SEC will recognize an NRSRO by a no-action letter process through SEC staff, but then will not regulate or oversee the NRSRO. The SEC has questioned whether or not it has the legal authority to regulate NRSROs[3,4]. This is interesting in light of the fact that

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[1] Annette Nazareth, Director, Division of Market Regulation, SEC testimony November 15, 2002 "HEARINGS ON THE CURRENT ROLE AND FUNCTION OF THE CREDIT RATING AGENCIES IN THE OPERATION OF THE SECURITIES MARKETS" page 185, lines 22-25. http://www.sec.gov/news/extra/credrate/credrate111502.txt

[2] Leo C. O'Neill, President, Standard & Poor's testimony November 15, 2002 "HEARINGS ON THE CURRENT ROLE AND FUNCTION OF THE CREDIT RATING AGENCIES IN THE OPERATION OF THE SECURITIES MARKETS" page 227, lines 3-22. http://www.sec.gov/news/extra/credrate/credrate111502.txt

[3] Annette Nazareth, Director, Division of Market Regulation, SEC testimony November 15, 2002 "HEARINGS ON THE CURRENT ROLE AND FUNCTION OF THE CREDIT RATING AGENCIES IN THE OPERATION OF THE SECURITIES MARKETS" page 186, lines 21-25 and page 187, line 1. http://www.sec.gov/news/extra/credrate/credrate111502.txt

[4] Robert Colby, Deputy Director, Division of Market Regulation, SEC testimony November 21, 2003 "HEARING ON THE CURRENT ROLE AND FUNCTION OF THE CREDIT RATING

the SEC believes that it has the authority to grant NRSRO designation. Because the SEC is giving almost monopolistic power to a designee it should either lobby Congress for the power to oversee the NRSROs or it should dismantle the NRSRO structure. I believe that dismantling the NRSRO structure would be harmful to the markets, thus the SEC should actively seek the authority to regulate and oversee NRSROs which to date it seems reluctant to do.

2.2. Consolidation (and expansion) occurs within healthy marketplaces. But there are occasions where consolidation hurts the market. Such unhealthy consolidation has occurred in the CRA marketplace. Regulatory agencies must take a proactive stance to stem this. Designating new CRAs will not be enough. Action must be taken that will not allow the largest CRAs to take over smaller struggling CRAs.

3. Regulators should do more than require CRAs to document and implement policies and procedures in regards to non-public information; regulators should clearly state what type of information would be considered non-public information, with an emphasis on ***very little information not being made available to the public***. The hearings held by the SEC on November 15, 2002 had extensive discussions about disclosing more information. Cynthia L. Strauss from Fidelity Investments Money Management, Inc. encapsulated it best when she stated, "I guess it's pretty simple. I think we would encourage companies to disclose, if it's that important to a rating, then it should be disclosed publicly."[5]
4. There have been complaints about anti-competitive actions taken by the largest CRAs[6,7,8]. These abuses need to be investigated and if found to be true, necessary

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AGENCIES IN THE OPERATION OF THE SECURITIES MARKETS" page 180, lines 3-15. http://www.sec.gov/news/extra/credrate/credrate112102.txt

[5] Cynthia L. Strauss, Director of Taxable Bond Research, Fidelity Investments Money Management, Inc. testimony November 15, 2002 "HEARINGS ON THE CURRENT ROLE AND FUNCTION OF THE CREDIT RATING AGENCIES IN THE OPERATION OF THE SECURITIES MARKETS" page 60, lines 23-25. http://www.sec.gov/news/extra/credrate/credrate111502.txt

[6] Steven W. Joynt, President and Chief Executive Officer, Fitch, Inc., testimony November 21, 2002 "HEARING ON THE CURRENT ROLE AND FUNCTION OF THE CREDIT RATING AGENCIES IN THE OPERATION OF THE SECURITIES MARKETS" pages 201-202. http://www.sec.gov/news/extra/credrate/credrate112102.txt

[7] William H. Donaldson, SEC Chairman letter to The Honorable Richard H. Baker, Chairman, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises with Memorandum from Annette Nazareth, Director, Division of Market Regulation, SEC dated June 4, 2003 to SEC Chairman Donaldson, question 10, page 8. http://www.sec.gov/spotlight/ratingagency/baker060403.pdf

[8] David Colling, Product Director, ABS Reports, Comments to S7-12-03 "Concept Release: Ratings Agencies and the Use of Credit Ratings Under the Federal Securities Laws" under section "Rating Agency Practice in Europe." http://www.sec.gov/rules/concept/s71203/absreports073103.txt

action should be taken to correct this behavior and to punish those that practice anti-competitive behavior.

In our own situation, we provided software and services to Standard & Poor's for users of their data for over a decade on CD-ROM. In January 2003, S&P informed us that they were thinking about canceling our contract and requiring users to use their on-line based system. S&P subsequently cancelled the contract and shutdown the distribution of the product in May of 2003. Because the product was still profitable for both S&P and my company, we asked S&P if we could license the data in order to continue supplying users around the world who did not need or could not access real-time data via the internet or who did not want wish to pay the increased cost for use of the data. S&P informed us that while they do supply their data through such companies as Reuters and Bloomberg, all contracts for data access are between the end users and S&P. S&P does not want any other party selling their data. They also told us that they do not want to have direct competition with their online product. These were the reasons they denied us a license to their data.

I wrote Annette Nazareth, Director, Division of Market Regulation of the SEC a letter on June 10, 2003 informing her that I believed that one of the issues raised by Congress to Chairman Donaldson of the SEC and responded to by her in a Memorandum dated June 4th, 2003 was about the product we supplied[7]. In that line of questioning Congress asked "Does this not suggest that the rating agencies exercise monopolistic power?" To date I have not had any direct response from Ms. Nazareth nor the SEC concerning this issue.

In another instance our attorney contacted the SEC through their web site and asked if the SEC regulates NRSROs. Their response was a link to a web page of frequently asked questions about NRSROs. The thrust of the answer was that they did not. As such, there was, and still is, no regulatory body that could act upon a ***complaint of fraud*** that we would have lodged against an NRSRO.

The above examples are further reasons why laws need to be enacted that give regulatory agencies authority as well as the responsibility to accept, investigate and where appropriate act accordingly on complaints about NRSROs.

5. CRAs should not be allowed to offer consulting or other advisory services. Testimony before the SEC during the November 15th and 21st, 2002 hearings by current NRSROs stated that this is not a major portion of their business. It is a dangerous and slippery slope to allow the CRAs to offer consulting or advisory services. It is understood, and believed, that the current upper management at the CRAs is sensitive to this issue. Nevertheless, the demise of Arthur Anderson and the current problems associated with the accounting industry serves as a clear warning as to what can happen and how rapidly it can happen when barriers are removed. The potential damage to investors, individuals, businesses, the marketplace and the economy is too great to allow this as a part of the CRA business model.
6. CRAs should be prohibited from issuing unsolicited ratings. There is a trust that is placed on the CRAs for their ratings. The potential damage and appearance of blackmail that unsolicited ratings bring greatly undermines this trust and therefore should be disallowed.
7. CRAs should divulge information that could affect ratings such as ratings triggers.
8. CRAs should be required to immediately divulge material risks as determined through the ratings process.

9. CRAs should not be allowed to start a ratings process and then not publish the rating. If a process is not completed or if a rating is pulled then the reason for such action should be published.
10. If a CRA turns down rating an issuer/issue then it should be published that an issuer/issue was turned down along with the reason why it was turned down.
11. Underlying information that is not proprietary to the issuer but is used in the ratings process should be published. For instance, Compustat, a division of S&P, publishes standardized accounting data. If such data is used in the ratings process then it should become part of the published information.
12. Information on how issues/issuers are rated in comparison to group/industries, where possible, should also be published.
13. One area that has been a problem is in access of data. Currently, most CRAs collect fees for rating an entity and then only release small portions of that data to the public. The CRAs then sell a more detailed analysis to customers that are willing to pay a subscription fee. Furthermore, CRAs control the data and in some cases license the data to other companies to include in their products, demand that certain companies license their data[8] and deny licensing to other companies that would like to include their data in their products. This anti-competitive behavior needs to be regulated. To address this it is suggested that an EDGAR like system be put into place as a repository for released ratings data. An EDGAR like system would help the marketplace to evaluate the performance of ratings agencies and analysts. In order for an EDGAR system to work to benefit the marketplace and not harm CRAs the following should be implemented.
    - 13.1. Most CRAs derive very little of their income from licensing their data. As such to make up for the loss of income a fee could be implemented by those that access the data. This fee could be used to offset the costs of maintaining a system and to reimburse the CRAs for their loss from licensing data.
    - 13.2. All data that is used to create informational ratings products must be released. That data includes, but is not limited to news articles, summary information, complete analysis, commentary data, structured financial data, issuer information, subsidiary data, insurance pools/group sets, issue ratings, information detailing analysts associated with ratings, watch information, alerts, tables, graphics/images, flat files and any other data needed to create products or that is necessary in using the data.
    - 13.3. CRAs must release detailed information regarding the structure of their data. Knowing how all the pieces fit together is important. As an example a commentary or news article can be linked to a variety of issuers. It is necessary to know how to lace the different pieces together. Such information should include the information that ties the data cohesively together, i.e. CUSIP's/ISIN's, organization identifiers, details as to primary and secondary CUSIP's/ISIN's, the organization of the rating, table information, membership rules, subsidiary and insurance pools and groups rules, rules used for segmentation (whether by industry, geography, financial instrument type or other rules) and any other information that details how the complete set of data is segmented to create various products.
    - 13.4. The complete historical data must be released. Currently when an issuer gets a revamped rating, the analysis and summary information from the previous rating is removed. This data is maintained by the CRAs but not always republished. To get a complete picture of how a CRA, analyst or set of analysts is performing over time, the historical data must be publicly available.

13.5. CRAs that create subscription-based products should be required to use realistic cost accounting in developing and maintaining those products and those costs should be represented in the price of their subscription-based products. Because most CRAs revenue is mainly derived from the ratings process, CRAs could create loss-leader subscription-based products and drive non-CRAs from the marketplace.

13.6. Because of the CRAs unique position (see 13.5 above), the CRAs should not be allowed to create hybrid products with other CRA data. For instance, S&P should not be allowed to present Moody's data in their products. This restriction will allow others to create products that are useful for analysis and education without unfair competition from the CRAs.

13.7. CRAs should be required to remove all advertising data before it is placed in an EDGAR based system. For instance, S&P includes in their releases advertising for their online product. A summary analysis from S&P contains a paragraph that states, "Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com." This information is not an integral part of the rating and as such should be removed from released data.

13.8. The CRAs name or logo should be allowed to be used in order to denote where the data was derived from. This will allow users of competitive products to understand which CRA data they are using.

13.9. CRAs should be required to retrieve data from an EDGAR based system before they show released data through their products. They should not only be required to retrieve the data, but process the data for inclusion into their products. This will keep CRAs from unfairly displaying their own data before the rest of the competitive marketplace has access to the data.

13.10. CRAs contain boards or committees that make directional changes to ratings policies. The boards and committees should work with the EDGAR based system staff so that changes won't disrupt others that are using the system. This might require that the boards, committees or the EDGAR staff to solicit and take into consideration outside comments to policy changes and address the affects of those changes before those changes can be implemented. At a minimum, changes to an EDGAR based system must be approved by the staff of the EDGAR based system or through the regulatory agencies and published with enough lead-time so that those using the system can implement changes to their own processes.

14. The CESR states in its annex that "This annex summarises the main strands of work underway internationally on credit rating agencies and which CESR is requested to examine during the preparation of its technical advice to the Commission." Most of the above comments were sent to the SEC, to the U.S. Congress and to AFTE, ACT and the AFP. In fact, except for a few additions and changes, the above information and format was sent to AFTE, ACT and AFP in May 2004. There are a few additional points directly made to AFTE, ACT and AFP concerning their "Exposure Draft: Code of Standard Practices for Participants in the Credit Rating Process" that also need to be included in recommendations for legislation. The following are those points:

14.1 The draft states "Each CRA should widely publicize any changes in its methodologies and allow a short period for public comment to the agency prior to the release of any rating announcement that might be the consequence to these changes"[9]. Because of the recommendations above in 13.10, the length of time for public comment might need to be set to a different timeframe than "short".

14.2 Item 6.1 of the draft states "Prior to public release, issuers should be given an opportunity to review the text of any rating action affecting their securities to ensure the accuracy of reported information and to remove any non-public information erroneously included in the text"[10]. There need to be safeguards put into place that only allow issuers the opportunity to look at the text for accuracy and removing of non-public information, not gain an insight into the rating before it is released to the public thus creating a situation where insider information could be used before the marketplace has an opportunity to access and act on rating actions.

14.3 Item 6.2 states "The CRA should disclose to the issuer the key assumptions and fundamental analysis underlying the rating action, as well as any other information that materially influenced the rating action and that could influence future rating actions"[11]. This same information should be disclosed to the marketplace, not just to issuers.

I look forward to the results of the call for evidences along with the hearings and final draft and public comments on the final draft. Thank you for allowing public input into an important and much needed process. I believe that all of the efforts previously mentioned and examined by your organization will bring about beneficial changes to the credit ratings marketplace.

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[9] "Exposure Draft: Code of Standard Practices for Participants in the Credit Rating Process", Association of Corporate Treasurers (United Kingdom), Association for Financial Professionals (United States), Association Francaise Des Tresoriers D'Entreprise (France), item 2.3, page 11. http://www.afponline.org/pub/pdf/code_std_practices.pdf

[10] "Exposure Draft: Code of Standard Practices for Participants in the Credit Rating Process", Association of Corporate Treasurers (United Kingdom), Association for Financial Professionals (United States), Association Francaise Des Tresoriers D'Entreprise (France), item 6.1, page 12. http://www.afponline.org/pub/pdf/code_std_practices.pdf

[11] "Exposure Draft: Code of Standard Practices for Participants in the Credit Rating Process", Association of Corporate Treasurers (United Kingdom), Association for Financial Professionals (United States), Association Francaise Des Tresoriers D'Entreprise (France), item 6.2, pages 12-13. http://www.afponline.org/pub/pdf/code_std_practices.pdf

Regards,

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