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BY ELECTRONIC MAIL AND POST

Mr Fabrice Demarigny
Secretary General
The Committee of European Securities Regulators
11-13 avenue de Friedland
75008 Paris
France

Re: *CESR's technical advice to the European Commission on possible measures concerning credit rating agencies – Consultation Paper (the "Consultation Paper")*

Dear Mr Demarigny:

We are writing in response to the Consultation Paper, published by the Committee of European Securities Regulators ("CESR") on 30 November, 2004. We welcome CESR's balanced approach to the subject matter, and manifest desire to show all sides of the issues highlighted in the Consultation Paper.

General Observation

We greatly appreciate CESR's expressed mandate from the European Commission to coordinate its response with those of other international bodies that are examining the role of credit rating agencies ("CRAs") in other contexts. In particular, we note that, since the publication of the Consultation Paper, the International Organization of Securities Commissions ("IOSCO") has issued the final version of its Code of Conduct Fundamentals for Credit Rating Agencies (the "Code"). As CESR recognizes in the Consultation Paper, many of the issues it raises have been addressed by the Code. The Code is the result of thorough consultation and discussion with all interested market participants over the course of the last two years. We strongly support recommendations in the Consultation Paper that CESR's final advice to the European Commission should follow the Code. Indeed, we believe that an atomized approach by local regulators to the global business of credit ratings would be anticompetitive – having to respond to a variety of different regulatory regimes in a multiplicity of jurisdictions, both initially and on an on-going basis, would create huge barriers to entry.

I. Introduction -- Definitions

In the first set of questions, CESR asks for feedback with respect to its proposed definitions of CRAs, credit ratings and unsolicited ratings. We believe that these definitions should be the same as those in the Code. Specifically, we note two changes that were made to the final draft of the Code. First, IOSCO deleted the word "primary" in the definition of a CRA, so that the definition reads: "those entities whose business is the issuance of credit ratings for the purposes of evaluating the credit risk of issuers of debt and debt-like securities". Thus, any entity (whatever its legal form, whether a company or a part of a company) that engages in a credit ratings business would be considered to be a CRA for purposes of the Code. Any other definition would be anticompetitive. Second, in the definition of a credit rating, IOSCO changed the words "**forecasting** the creditworthiness of an entity" to "**regarding** the creditworthiness of an entity", because a credit rating is not a *forecast* of creditworthiness, but simply an opinion *as to* creditworthiness.

II. Barriers to Entry

We welcome CESR's recognition that accurate ratings can be produced solely on the basis of publicly available information – which is often the case for unsolicited ratings. (In fact, we would advocate increased public disclosure for all European issuers, as a general good for the market.) And CESR is quite right to point out that a prohibition on the issuance of unsolicited ratings may constitute a barrier to entry for new CRAs. We note that IOSCO appears to have reached the same conclusions, given its recognition of unsolicited ratings in measure 3.9 of the Code.

We believe that the perception of limited competition in the area of independent credit research and analysis is not supported by the reality of the competitive marketplace. As is well known in the market, there are other rating agencies operating in Europe than the traditional NRSROs. In addition to rating agencies, there is extensive so-called "sell side" credit research and analysis available from the research departments of investment banks, as well as a large number of organisations throughout Europe and in other developed markets devoted to independent credit research and analysis. Some of these organisations' work is based on model-driven analysis, while others engage in more fundamental credit analysis. They distribute their research and analysis in a variety of ways and use a variety of different business models. Some examples of these organisations are CreditReform, HypRating and Euler Hermes.

Beyond the need to maintain the ability of CRAs to issue unsolicited ratings, we do not see any barriers to entry that need to be addressed by legislation or regulation. Indeed, we think that additional legislation or regulation would increase, rather than decrease, barriers to entry. This view was expressed by others at the public hearing before CESR's taskforce in Paris on 14 January, 2005 (the "CESR Public Hearing"), such as the representatives of ISMA, the ACT and the BMA.

III. Rules of Conduct

Conflicts of Interest. We generally agree with the approach to potential conflicts set forth in the Code, and echoed by CESR in its questions here – that is, the CRA should have policies and procedures in place to manage and disclose potential conflicts of interest, and these policies and procedures should themselves be disclosed. CESR also asks if CRAs should disclose whether these policies and procedures have been applied for each credit rating. We believe that this latter suggestion would lead to boilerplate disclosure, and instead recommend that CRAs disclose, with respect to individual credit ratings, when their conflict policies and procedures have not been applied.

CESR asks about five specific areas of potential conflict: payment of fees by the issuers; provision of ancillary services by the CRAs; issuance of unsolicited ratings; issuance of structured finance ratings; and financial or other links between CRAs and issuers. We address each of these in turn.

With respect to the fact that our ratings are paid for by the issuers being rated, it is interesting to note that, in the vast majority of submissions and testimony given by market participants on this subject in the last several years, no concerns have been raised about this fee paying relationship, nor were any concerns raised at the CESR Public Hearing. Indeed, we believe this is because the market is well aware of the fact that we receive fees from issuers, and well aware of how we manage the potential conflicts. CESR suggests, however, that more may be needed, in asking whether we should disclose our fee scheme and whether this fee scheme has been applied in each particular rating. We currently disclose the range of our fees. We think this is adequate, and we think market participants agree with us. Any greater disclosure would mean providing proprietary information to our competitors, which could be potentially damaging to us and anitcompetitive.

With respect to ancillary services, we agree with the approach taken by IOSCO in measure 2.5 of the Code – that those ancillary businesses that may present a conflict of interest should be kept separate from the credit rating business, and those that do not necessarily present a conflict of interest should be subject to procedures designed to minimise the likelihood that conflicts will arise. We also note that we perform a ratings advisory service – that is, rated issuers will ask us for feedback about the impact of various hypothetical scenarios on their existing ratings. We consider this service to be an integral part of the credit rating business, rather than an ancillary service, and believe that it presents no conflicts of interest.

With respect to the issuance of unsolicited ratings, we do not see any conflict of interest. We think the disclosure policy outlined in measure 3.9 of the Code is the best approach to unsolicited ratings.

With respect to structured finance ratings, we see no conflicts at all; we note that this did not come up as an issue during the CESR Public Hearing. As CESR points out, structured finance ratings are fundamentally the same as corporate ratings. The difference is in the process – structured finance transactions develop over time, as the transaction parties discuss and explore the various ramifications (economic, legal, tax, accounting, etc.) of any proposed structure. That

means that, during the course of the rating process, the structuring parties will bring forward to the CRAs a series of amended structures and ask for feedback on the ratings and credit enhancement levels, which is consistent with our commitment to a transparent rating process; the CRAs do not provide structuring advice.

Finally, with respect to financial and other links between CRAs and issuers, we again agree with the principle that a CRA's conflicts policies and procedures should cover this area as well, as discussed in the first paragraph of this section.

Fair Presentation. As CESR highlights in its discussion, most market participants do not think it appropriate for regulators to impose criteria on the rating methodologies of CRAs. Such regulatory intervention could have a negative impact on the perceived independence of CRAs, and could also imply that a regulatory authority has approved the CRAs' methodologies – thereby leading to potential moral hazard. We do, however, understand the desire for some kind of external proof that the rating methodologies have been developed correctly and are being applied correctly, and that they actually work. We think this desire can best be fulfilled through a combination of two elements: transparency of methodologies and disclosure of historical results. And we note that this is the approach taken by IOSCO as well.

First, we believe quite strongly that the processes and procedures that rating agencies use should be transparent. We are also in agreement with IOSCO's approach, in measure 3.10 of the Code, to material modifications to methodologies: such modifications should be disclosed, and where feasible and appropriate, should be disclosed prior to going into effect. We note that IOSCO specifically asked for comment as to whether such modifications should always be disclosed prior to becoming effective. As IOSCO recognises in its final text, it is not always possible to disclose beforehand, given that some methodological modifications result from changes in world events or changes in industry dynamics that are fast moving and unforeseen. In such cases, it is more important that the methodology be changed, and the ratings revised accordingly, on a timely basis.

Second, we think it is of utmost importance for investors and other users of ratings to see how the ratings have performed over time, as demonstrated in default studies and transition studies. Default studies will show the historical rates of default within each rating category of the rating agency, and transition studies will show the stability of the ratings. In the past, these studies have shown that defaults and transitions are highly correlated to the rating level.

At the end of the day, the most definitive external proof that the methodologies and ratings work, that the rating agency's staff has sufficient expertise, and that the ratings themselves are not biased, is the extent to which the market uses the ratings of a rating agency. As a practical matter, we believe that the market provides more than adequate regulation of the ratings process and outcomes. It is worth noting that we are already broadly compliant with the Code, because that is what the market has already expected of us. If the market wants to see risk warnings or market indicators included in our ratings reports (two suggested rules proposed by CESR for comment), or the inclusion of any other additional information, then they will make those desires very clear to the CRAs, and we will respond accordingly.

Relationship between Issuers and Rating Agencies. The first area highlighted by CESR is access to inside information. We agree with the suggestion by CESR that the Market Abuse Directive (together with the provisions in the Code dealing with the use of confidential information) adequately covers the potential misuse of inside information by CRAs and their employees. We see no reason, in this context, to distinguish CRAs from any other market participant. Likewise, to the extent that a CRA's potential rating actions could be inside information, we believe that the Market Abuse Directive provides adequate protection for the misuse by issuers of such information. In a related vein, CESR has asked whether issuers should be required to disclose a potential rating action if such action constitutes inside information. We strongly disagree. It is our policy typically to provide a copy of any press release and any rating report to the relevant issuer, shortly prior to publication, to allow the issuer to check the accuracy of any facts referred to, and to ensure that none of the issuer's confidential information has been disclosed. As CESR itself points out, it is in the interest of the market that we allow this opportunity to the issuer; in CESR's own words, it would be counterproductive to force issuers to disclose the potential rating actions, since that would discourage the CRA from notifying the issuer in advance of any action.

With respect to such prior notification to the issuer, CESR asks what, if any, measures need to be introduced to ensure issuers have the opportunity to discuss and understand the basis for a rating decision. We believe that measure 3.7 of the Code strikes the right balance between an issuer's desire to receive prior notification, and competing interests, such as the need to take prompt rating action to ensure the accuracy of the relevant rating. CESR also asks whether issuers should have a right to appeal. We note that this question was discussed during the course of drafting the Code, and the final Code contains no right of appeal – we strongly believe this is the correct outcome. It is our typical practice to allow an issuer to appeal a rating decision, provided the issuer has new information to share with us; our concern with an automatic right of appeal would be that certain issuers would use such a right as a means to delay publication of an unfavourable rating action.

CESR raises the question of whether the Code and the Market Abuse Directive are sufficient to ensure information published by CRAs is accurate. Our general answer is yes, but we think it is important to distinguish between a CRA's ratings, and the information on which those ratings are based. First and foremost, CRAs publish their opinions on the creditworthiness of issuers and of debt instruments. It is always our aim to be as accurate as we can in the ratings that we issue – especially because investors will cease to use our ratings if they find them to be inaccurate. However, a rating is still an opinion – it is not a fact itself. Moreover, the facts on which we rely to make our ratings decisions are provided to us by the issuers themselves, and their agents and advisors. CRAs do not audit or verify this information, and assume it to be accurate. Fitch makes our approach very clear in our published ratings definitions and elsewhere in our publications and website. We therefore assume that this reference to the accuracy of information published by CRAs is not intended to impose any requirement on CRAs to audit or verify such information. (In this context, we found the reference in the Consultation Paper to due diligence in paragraph 65, and to a "policing" function of CRAs in paragraph 93, each to be misleading.)

In addition, as is also stated in our published ratings definitions and in the disclaimers that appear in our published reports, the maintenance of a rating is contingent upon the availability of current

financial information acceptable to us and the availability of other information we deem necessary to maintain a rating. CRAs do not possess the power, nor should they, to compel cooperation of the issuer in providing to us all of the information we need in order to make our assessment. We can only request such information from the issuer and trust that the issuer will comply with these requests by providing full and fair disclosure of all of the needed information. Indeed, CESR might want to consider advocating worldwide standards that would improve, and make consistent, the public disclosure required of issuers so that anyone can perform the same quality of credit analysis as a CRA without the need to have access to nonpublic information. The standard should be such that anyone would be able to use this public information to produce an opinion as to the creditworthiness of an issuer or security.

IV. Regulatory Options concerning Registration and Rules of Conduct for CRAs

As CESR itself recognises, the introduction of a regulatory regime of any type will, by definition, increase barriers to entry. We believe, therefore, that a lighter approach is the most appropriate. Option 6 seems to us to be the best approach for the moment, and, indeed, received overwhelming support – from issuers, investors and ratings advisors – during the course of the CESR Public Hearing, as well as during the hearing conducted by BaFin on 11 January in anticipation of the CESR Public Hearing. As CESR points out, the Code has yet to be implemented; CEBs is only just beginning its work on the specific criteria for ECAI recognition. It would be prudent to monitor these initiatives to determine whether any additional regulation, or some kind of registration system, is justified. CESR has identified potential negatives to this approach; we think these concerns are misplaced, especially compared to the negatives presented by the other five proposed solutions. First, CESR refers to the potential for "an uncontrollable shift of power to the CRAs themselves, away from the investors and especially away from the issuers". Because both issuers and investors use ratings, and because they often have widely diverging views, CRAs can only function well by producing independent, unbiased ratings and research. And if a CRA's ratings are consistently inaccurate, the market will stop using that CRA. The fact that we must respond to the demands of the market has prevented, and will continue to prevent, CRAs from developing any such power. Similarly, as we mentioned above, we are already broadly in compliance with the Code because that is what the market expects. The market already creates an equilibrium among the various participants.

With respect to the other options, as CESR has noted, given the existence of the ECAI regime in the Capital Requirements Directive (the "CRD"), any EU registration system will involve duplication of effort, both for the competent authorities as well as the CRAs, and would be highly anticompetitive. One of the proposals, Option 5, would allow each Member State to implement the Code in its own fashion, in addition to ECAI criteria, thereby leading to the possibility of 25, or possibly even 50, different regimes. Another proposal, Option 4, would look to a third party to certify or enforce compliance by a CRA with its code of conduct. This essentially means that regulation of the CRAs would be privatised – we fail to see what entity could be found to undertake this role in a truly independent way. We also note that IOSCO asked explicitly for comment on whether compliance with the Code should be through an arbitration body; that suggestion was not incorporated in the final Code.

We think it important to comment on an observation made by CESR in discussing the disadvantages of Option 3 (whereby ECAI recognition would include an assessment of whether the CRA complied with the Code). CESR states that the Code is intended to apply internationally, whereas the CRD contemplates the ability of the competent authorities in a Member State to recognise an ECAI only in that Member State. We think this is an incorrect interpretation of the applicability of the Code. By its very terms, the Code states that it is "intended to be useful to all types of CRAs relying on a variety of different business models"; there is no suggestion that the Code only applies to international CRAs – in fact, just the opposite is true. And any other interpretation would be anticompetitive.

Thank you for the opportunity to be a part of this extremely important process. Please call me at your convenience at +44 20 7417 4228 with any questions that you have about our comments or to discuss this matter further.

Sincerely yours,

s/ Paul Taylor

Paul Taylor
Group Managing Director
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