International Securities Market Association
International Primary Market Association
Danish Securities Dealers Association
London Investment Banking Association
Swedish Securities Dealers Association

We provide this evidence jointly in order to assist CESR by providing one document rather than five. For the purposes of its analysis of responses, CESR should however count this evidence five times, and weight it accordingly

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Response to CESR's consultation on its technical advice to the European Commission on possible measures concerning credit rating agencies

Introduction

We would like to congratulate CESR on the approach it has adopted in dealing with this important and globally significant issue. Two hearings, a call for evidence and finally this consultation paper amount, if we may say so, to an exemplary approach. We hope that CESR will find our comment useful, particularly as regards the six regulatory options which we understand will form the basis for CESR's consideration of the advice it will give the Commission.

Key features

We believe the following:

- That the IOSCO Code sets out comprehensively and proportionately the standards of conduct which CRAs should strive to meet while recognising that not every CRA will have the resources to meet all the requirements

- That self-regulation by CRAs based on adherence to the IOSCO Code wherever practical, validated by external audit and supported by pressure from the users of ratings, is the best way to enhance standards and promote competition

- That statutory registration and regulation will increase the barriers to entry into an industry in which barriers imposed by issuers and investors are already high

- That the EU should refrain from extending the official recognition and requirement to use ratings beyond the present requirements in the CRD

- That the single most important change which would enhance the ability of EU based CRAs to compete, in the EU and globally, would be for the US SEC to give up its NRSRO regime or to open it up to additional CRAs on the basis of open and transparent criteria.

Responses to the questions

Section 1

Do you agree with the definition of credit rating agencies? If not please state your reasons.

The differences are subtle and the CESR definition appears to be broader than the IOSCO definition, not narrower as stated in the Consultation Paper (CP). For example, the CESR definition includes entities which carry on business in addition to the issuance of credit ratings. It also includes the issuance of credit ratings on issuers of securities other than 'debt and debt-like securities, unless the 'or' in the CESR definition should be 'of'.

While these distinctions may eventually have an impact depending on the approach the EU adopts with regard to CRAs, for the purpose of CESR's current work, probably the key issue is that CESR has chosen, correctly in our view, not to adopt the CRD criterion for ECAIs that they have 'credibility and market acceptance'. In some circumstances this amounts to a serious entry barrier to new entities seeking to enter the business, as is the case with the SEC's NRSRO system.

It will also be important to ensure that institutions other than pure CRAs are able to carry out CRA - like business, such as rating the claims paying ability of insurance companies, in addition to their primary business.

Do you agree with the definition of credit ratings? If not please state your reasons.

Yes.

We agree with this definition as long as it is clear that opinions published in other fora, for instance in the media, are excluded.

Do you agree with the definition of unsolicited ratings? If not please state your reasons.

No.

We would not support a definition based on one element since the relationship between a CRA and an issuer is often more complex. Although the question of 'who takes the initiative' test is highly relevant there are other factors, such as the degree of cooperation, if any, by the issuer. This is recognised in para 3.9 of the IOSCO Code. From an investor's perspective, and as the IOSCO Code recognises, disclosure of both of these elements is key. We believe that the question of whether or not the rating has been paid for is also important and should also be disclosed.

Do you think that issuers should disclose rating triggers included in private financial contracts?

This issue has broader implications and we believe that it should be considered in the context of issuer disclosure under the Prospectus and Transparency Directives rather than in a consultation on CRAs.

Do you think that the use of ratings in European legislation should be encouraged beyond the proposed framework for capital requirements for banks and investment firms? If yes please provide examples.

No.

The EU has decided to require the use of ratings by banks that do not have internal risk models in the CRD. It should refrain from extending further the official recognition and requirement to use ratings

If the EU does not embed the use of ratings in a wide range of legislation and regulation, there is less need for regulation of CRAs. The EU has the opportunity to avoid the United States mistake of making ratings so important by using them in a great deal of regulation that the regulator is obliged to determine which rating agencies are acceptable and may feel that it must impose substantive regulation.

Examples of areas to be avoided are solvency ratios for insurance companies and pension funds, eligible assets for collateral and repo, suitability requirements for investors and legal investments under fiduciary rules or for managed accounts.

Furthermore, the more reliance can be placed on credit ratings provided by CRAs the less will institutions be obliged to make their own independently researched decisions on what to invest in and who to deal with when carrying out business on behalf of their clients. Limitations to invest in, for example, only investment grade bonds, can easily become safe harbours in the face of market recognition that a credit is deteriorating but where that has not been recognised by the CRAs. Legislation should not, a priori, encourage or discourage the use of any particular service

<u>Section 2</u>

Do you think there is a sufficiently level playing field between CRAs or do you think that any natural barriers exist in the market for credit ratings that need to be addressed?

We believe that the CP describes very well the natural barriers which exist in the market for credit ratings which make it difficult for new entrants to gain a foothold and for small CRAs to expand. Neither is impossible however, as the creation and growth of International Bank Credit Analyst (IBCA, now part of Fitch) in the UK in the 1980's demonstrates.

We do not believe that legislative or regulatory intervention can be effective in breaking down these barriers, such as investors preferring to rely on CRA's with a proven track record and issuers wishing to limit interaction with CRAs to the minimum numbers necessary to secure investor support. New or small CRAs are inherently disadvantaged when dealing with both groups. This is not unique to CRAs. It is true within many other sectors within the financial services industry and indeed, most other industries.

We agree with those commentators referred to in para 63 of the CP that government recognition or registration can itself constitute a barrier, particularly if some element of market acceptability is one criterion, as is the case in the US and as proposed for the CRD.

Do you believe that coverage of certain market segments or certain categories of economic entity (such as SMEs) may be sub-optimal? Are there measures that *regulators could use to affect this scenario? Which are they and would it be appropriate to use them?*

Broadly speaking we do not believe that coverage of some market segments or economic entities is sub-optimal at least as regards the issuance of securities. There may well be a problem, and one that will become more intense, with the implementation of the CRD in its current form, if a significant number of banks choose to use ECAIs instead of developing their own internal credit assessments. We recognise the risk that this could result in a reduction in the availability of bank credit or an increase in its cost for SMEs, which cannot afford the cost of a rating by an ECAI. If this happens it would be regrettable and we would hope that prudential regulators would take steps to ameliorate the problem. In the capital markets we would hope that SMEs will increasingly turn to the public <u>equity</u> market, where credit worthiness of an issuer is less relevant to investors than a firm's overall prospects, rather than merely seek to exchange bank credit for bonds. We recognise that today, when the costs of regulation in the EU are low, there are limits to how far the costs of preparing a credit rating can be reduced while still maintaining high standards in the process. Increased regulatory involvement can only put upward pressure on those costs, which will put obtaining a credit rating even further beyond the capacity of most SMEs than it is today.

<u>*Section 3*</u>

To what extent do you agree that in order to adequately address the risk that any conflicts of interest might adversely affect the credit rating it is sufficient to have the credit rating agency (i) introduce and disclose policies and procedures for management and disclosure of conflicts of interest, and (ii) disclose whether the said policies and procedures have been applied to each credit rating?

This formulation of the question is a feature of the CP. Generally, as in this case, our response is to agree with proposition (i). We are however concerned that mandating specific disclosure as set out in (ii) in the case of each credit rating issued will require a large amount of routine disclaimers or 'boilerplate' to be attached to each rating which will hinder investor access to the detail of the rating itself. We believe that in this and the other situations set out in subsequent questions (the exception being the disclosure of whether a rating has been solicited or unsolicited) it would be sufficient for CRAs to make the disclosure on an exception basis. That is, to disclose only when the relevant policy and procedures etc have <u>not</u> been applied.

Do you consider that to adequately address the risk that the provision of ancillary services might influence the credit ratings process it is necessary to prohibit a credit rating agency from carrying out those services? If your answer is yes, how would you address the entry barriers that could be created by imposing such a ban?

No.

In para 81 of the CP CESR describes a range of ancillary services which a CRA might provide to an issuer. We see no need to prohibit a CRA from providing such ancillary services as long as, with one exception, the services are separated from the credit rating process by appropriate Chinese Walls. The exception is the preparation of hypothetical ratings, where the expertise of the credit analysts engaged in developing conventional ratings credit is essential. Indeed, it is difficult to see how valid hypothetical ratings, consistent with a CRA's current ratings of an issuer or its securities, could be prepared without their participation.

Do you think that structured finance ratings give rise to specific conflicts of interest that should be addressed in CESR's advice to the Commission?

No.

Rating structured products does not in our view give rise to specific conflicts of interest. We note that this is also the conclusion of a working party of the Committee on the Global Financial System, published by the BIS in January 2005[1] It can however involve CRAs to a greater degree than normal in advising on the precise terms of the product, as CESR has recognised in para 82, although the differences may not be clear-cut. CRAs have not always been prepared, at least publicly, to acknowledge this greater responsibility which, in our view, requires them to manage with particular rigour the relationship with the issuer, particularly as a regards the competences of the credit analysts involved and their interaction with employees of the financial institution or other entity who are preparing the product.

To what extent do you agree that in order to adequately address the risk that the provision of ancillary services might influence the credit ratings process it is sufficient to have the credit rating agency (i) introduce and disclose policies and measures managing and disclosing multiple business relationships with issuers in general and the issuer being rated in particular, and (ii) disclose whether the said policies and procedures have been applied in each credit rating?

We agree that (i) is sufficient. As regards (ii) we prefer exception disclosure for the reasons set out above.

To what extent do you agree that in order to adequately address the risk that an issuer paying for a credit rating might influence its ratings it is sufficient to have the credit rating agency (i) introduce policies and procedures, including but not limited to the introduction of a fee scheme (ii) disclose its fee scheme and (iii) disclose whether the fee scheme has been applied in each credit rating?

We agree that (i) and (ii) are sufficient. As regards (iii) we prefer exception disclosure for the reasons set out above.

In order to deal with issues related to unsolicited ratings, to what extent do you agree that it is sufficient to have the credit ratings agency (i) introduce and disclose policies and measures with regard to issuing unsolicited credit ratings and (ii) disclose when a particular rating has been unsolicited?

Subject to our preference for an expanded definition of the term 'unsolicited' as set out above, which we believe will be more informative for investors, we agree that (i) and (ii) are sufficient.

To what extent do you agree that in order to adequately address the risk that any financial or other link between a credit rating agency and an issuer might influence the credit ratings process it is sufficient to have the credit rating agency (i) introduce policies and measures managing and disclosing financial links or other interests between a credit rating agency and issuers or its affiliates or investments in general and the issuer or its affiliates or investments being rated in particular, (ii) disclose the

[1] The role of ratings in structured finance: issues and implications: page 26, 'The potential conflicts of interest arising in structured finance are thus unlikely to be materially different from those in the traditional segments of the agencies' business.'

said policies and procedures and (iii) disclose whether the said policies and procedures have been applied in each credit rating?

We agree that (i) and (ii) are sufficient. As regards (iii) we prefer exception disclosure for the reasons set out above.

<u>*Section 4*</u>

To what extent do you agree that in order to adequately address the risk that lack of sufficient or inappropriate skills might lead to poor quality credit ratings it is sufficient to have the credit rating agency (i) introduce policies and measures managing and disclosing levels of skill of staff, (ii) disclose the said policies and measures and (iii) disclose whether the said policies and measures have been applied in each credit rating?

At most we believe that (i) and (ii) are sufficient. As regards (iii) we prefer exception disclosure for the reasons set out above. In any case it is unclear to us what added value users of ratings would obtain from such disclosure. We are not aware of evidence of market failure resulting from inadequate skills of analysts employed by rating agencies. Furthermore there will always be a lively and irresolvable debate on whether a young person with a recently attained high-level qualification is superior to someone with a lesser qualification but who has many years of practical experience.

Do you have any alternative approaches to address the actual or potential risk that lack of sufficient or inappropriate skills might lead to poor quality credit rating assessments?

No.

We believe that users of credit ratings (including issuers) are best placed to influence the skill base of CRAs based on direct experience of dealing with analysts employed by CRAs and on the disclosure statements provided.

Do you think that undisclosed methodologies could lead to biased credit ratings or to biased interpretations of credit ratings?

It is unclear what the Commission was seeking in its request for advice on this point. A biased rating, in the sense of one that is prejudiced, unfair or improperly influenced, seems unlikely to arise from a defect in methodology, whether or not disclosed. IOSCO, in its Code at para 1.8 appears to see the risk of bias residing in the composition of a CRA's rating teams, which may relate to concerns about the mix of skills and backgrounds of the analysts concerned. We are similarly unsure whether, as regards interpretations of ratings by investors, CESR's concern is about bias or whether it concerns investors being, unknowingly, poorly informed.

In any case, for us the point is moot since we believe that a CRA should publish sufficient information about its procedures, methodologies and assumptions so that outside parties can understand how a rating was arrived at by the CRA, as set out in section 3.5 of the IOSCO Code. The qualification of 'sufficient' arises solely from our concern that greater transparency of process should not enable issuers to exercise inappropriate pressure on CRAs. Our objective is to safeguard the integrity of the rating process, thereby securing its usefulness to investors.

Do you see more advantages or disadvantages in the regulation of CRAs methodologies by securities regulators? Please describe the advantages and *disadvantages that you consider and which is the best way of dealing with them. Do you believe that this regulation would contribute in some ways to lead to common global standards for CRAs?*

We believe that the disadvantages in going beyond the IOSCO Code, which is properly circumspect in this area, far outweigh any possible advantages. Not only would greater intervention by regulators create a moral hazard problem for regulators, as CESR recognises in the CP, but there is a significant risk that investors will interpret regulator involvement as providing government with an opportunity to improperly influence ratings of their own sovereign debt or the debt of industrial companies or banks where the state has a large shareholding or explicitly guarantees the issuers' obligations. Even if this perception is ill founded, its impact would be to damage the credibility of the ratings concerned and eventually the credibility of any CRA subject to such regulation. Additionally, regulators are unlikely to be able to act quickly enough to mandate changes to methodologies in response to changing market conditions, thereby causing the use of inappropriate methods. Finally, the existence of regulator determined 'official ' methodologies implies that regulators are better able to determine through regulation (as opposed to the providers and users through competition) how CRAs should operate.

Do you believe provisions of the IOSCO Code are sufficient, in terms of rules on CRAs' methodologies and the corresponding disclosure? Do you believe that CRAs should disclose to issuers changes in methodology before starting to use new methodologies?

We believe that the IOSCO Code is sufficient. We believe that advance disclosure of changes to issuers <u>and users</u> of ratings is necessary and important. We understand that some CRAs are already committed to such disclosure and the acceptance of this principle by others will, we believe, enhance investor protection.

Do you believe that regulation should concern all aspects of CRAs' methodologies? How appropriate is the choice of explicitly regulating the four proposed issues (disclosure and explanation of the key elements and assumptions of a rating, indication of some forms of risk warning, rules on updating of ratings and the inclusion of some market indicators within a rating opinion)? Would you deal with these issues by self-regulation?

As set out in the overview to this response we are in favour of market driven self-regulation of CRAs for reasons which we discuss in detail in our response to the question on the regulatory options below.

Furthermore we fully agree with the criticisms of the risks inherent in the regulation of CRA methodologies which CESR has recorded in para 116 of the CP. IOSCO has, rightly in our view, been very cautious in setting out Code requirements in this area. As noted in our responses above we are supportive of disclosure of the key elements and assumptions of a rating. We also support CRAs adhering to a comprehensive programme of updating ratings when necessary.

We are reluctant to endorse the publication of risk warnings because, as CESR has recognised, these would inevitably be selective. Often in financial markets it is the unexpected which does the most damage. As regards benchmarking, we are sympathetic to the proposition in the CP that this is something investors or their advisors can (and in our view should) do. Benchmarking is also relevant to pricing and not rating and is important to an investor when making the decision to buy or sell not when the rating decision was made.

Section 5

Do you consider that the combination of the requirements of the Market Abuse Directive in this area and the requirements of the current version of the IOSCO Code adequately address the issue of access to inside information by CRAs?

Yes

The Market Abuse Directive will, we believe, substantially increase the awareness of their responsibilities to the market of all market participants, be they banks, investment firms, issuers, investors (institutional and retail) and CRAs. The last will also be subject to the IOSCO Code (on a self-regulatory, market driven basis we hope). Unless this combination is demonstrated to be insufficient over the few years we expect this to be more than adequate.

What is your view on requiring an issuer to itself disclose an imminent rating change where it has been advised of this by a CRA and where the rating announcement may itself amount to inside information in relation to the issuers' financial instruments?

We are opposed to this proposal. Putting aside the question of whether the rating announcement would, as a matter of fact, amount to inside information, we think that the market benefits from these announcements being made as they are today, in an even-handed and dispassionate way, by the CRA.

Do you consider that the requirements of the Market Abuse Directive in this area sufficiently address the risks that inside information might be disseminated, disclosed or otherwise misused?

Yes.

Please see our comments on the impact of the Market Abuse Directive above.

Are there any other issues concerning access to inside information which CESR should consider from the perspective of establishing a level playing field between CRAs?

No.

As we have observed above, we do not believe that regulators have a role to play in establishing a level playing field between CRAs and attempts to do so are likely to be viewed with suspicion by investors, to the detriment of those CRAs the 'levelling' was intended to help.

Are there any other issues concerning the Market Abuse Directive's provisions concerning inside information that you consider to be of relevance to CRAs and their activities which need to be considered?

No.

Do you consider it would be helpful to have a dedicated regime governing CRAs and their access to inside information?

No.

This view is consistent with our overall position that based on the evidence to date, there is no need for statutory intervention in the regulation of CRAs and that as regards insider information, the Market Abuse Directive and the IOSCO Code provide sufficient safeguards.

Is this provision sufficient to ensure that issuers have an opportunity to discuss and understand the underlying basis for any rating decision? If not, what other measures do you consider should be introduced?

We presume the reference in this question is to what is now section 3.7 of the definitive version of the IOSCO Code. We believe these provisions are sufficient. It is important to the integrity of the rating process that CRAs do not permit issuers to engage in a process of haggling over the rating.

In addition to being able to discuss the basis for a rating, should an issuer have a 'right of appeal' where they disagree with the CRA's opinion?

No.

This would only delay publication at precisely the time when it is important to get the opinion, and the reasons underlying it, into the public domain so that investors can make properly informed investment decisions. It would also be used only in a one-sided manner. In practice, no issuer will ever challenge an upgrade (however unrealistic it might privately believe the rating to be) but will only challenge an initial rating it finds disappointing or a downgrading.

Do you consider the provisions of the current draft IOSCO Code and the Market Abuse Directive to be sufficient to ensure that information published by CRAs is accurate?

Yes.

Usually accuracy will be contested not with respect to information but with respect to opinion. Accuracy can never be <u>ensured</u>. But together the IOSCO Code and the Market Abuse Directive provide (to the extent that the IOSCO Code is adopted in a market driven self-regulatory framework) a mechanism which to the greatest extent possible will incentivise CRAs to be accurate.

Given the lack of specificity in the current draft IOSCO Code to maintain internal records for any particular time period, do you think more specific measures would be appropriate, requiring for example all the information received by a CRA to be kept, along with records supporting its credit opinions, for a minimum of five years?

In most countries, company law requirements on document retention for several years will apply in any case.

Do you consider that it would be appropriate to introduce measures requiring the establishment of a rating agency data room to ensure that all CRAs have access to the same information concerning a particular issuer?

No.

The proposal is not practical given that each CRA employs different methodologies in arriving at its ratings and therefore needs access to different types of information. It is often the case that issuers receive 'split ratings' which indicate that different agencies have placed different emphasis on different aspects of information and have arrived at different opinions regarding the same issuer. An issuer could not be expected to segregate all the data that two or three (or more) CRAs require, nor would it be right to deny a CRA access to data it requires merely because it was not available in the data room and therefore not accessible to all CRAs with which the issuer has a relationship. If a data room requirement was imposed, it would put pressure on CRAs to adopt similar or even identical methodologies. The reduction in diversity of approach would heighten the risk of CRAs, as a group, failing to recognise a problem until too late.

<u>Section 6</u>

Could you assess the policy options concerning the need for regulation or other measures, with particular reference to the practical implications for competition in the rating market and for the quality of ratings and of information to the market? In particular:

Option 1. A full registration/regulation regime based upon detailed criteria.
Option 2.A lighter registration/regulation regime essentially based upon the IOSCO Code.
Option 3. To assess compliance to IOSCO Code Fundamentals in a parallel process to CRD's recognition.
Option 4. A third party's certification or enforcement of the IOSCO Code.
Option 5. Relying upon rules covering only specific aspects of CRAs activities.
Option 6. Monitoring the market developments.

We believe that the analysis of the six options in the CP is an essentially accurate representation of the pros and cons of each option. However, the discussion appears to be predicated on two assumptions with which we fundamentally disagree.

The first is that there has been a market failure within CRAs for which statutory regulation is necessary and proportionate. CESR has put forward no evidence to support that assumption.

The second is that self-regulation by the credit rating industry is a second-best approach which is likely to fail.

We believe that the paradigm in which the regulator should operate is one where it identifies the market failure and the cause thereof; and justifies its preferred solution as the most cost effective among the possible solutions, including that of doing nothing.

Could you please indicate your preferred option and highlight pros and cons that you see with regard to each policy option?

We believe that self-regulation by CRAs, which is an emerging trend, albeit motivated in part by the threat of regulation, coupled with the growing willingness of users of credit ratings to demand high standards from CRAs, is a viable way forward which will minimise costs and promote competition. We recognise that increased user involvement has resulted not just from concern over scandals such as Enron and Worldcom but also from the need to think more deeply about their own responsibilities as a result of initiatives such as this consultation.

Our strong preference is for a combination of elements of Option 5 with Option 6.
In its discussion of Option 5 the CP, in para 187, discusses two approaches. The first is to deal with the Code in the context of self-regulation whereby a CRA would disclose to regulators and the market its 'degree of implementation of the (IOSCO) Code'. We support this approach. We believe that, in addition, verification of the position should be included in the annual statement by a CRA's external auditor.

In its discussion on option 6 the CP refers to the generally positive comments at the October 8, 2004 hearing from market participants on the current position. With the exception of the association of independent German analysts which appears to have some problems unique to Germany, our perception is that this consensus view was repeated at the hearing on January 14, 2005.

From all users of ratings, investors, issuers and investment firms, the view appears to be that there is currently no market failure for regulation to address while recognising that there is now a global standard, the IOSCO Code, which CRAs should strive to adopt in the management of their business. Several have produced their own Codes of Conduct which may need some further modification to reflect the final version of the IOSCO Code. From a user perspective these are all highly positive developments which we believe should be given time to take effect without further regulatory intervention.

Option 6 would also be consistent with the growing acceptance of the policy of regulatory intervention only when there is a demonstrable market failure which market participants are unable or unwilling to correct.

Furthermore we have doubts as to whether statutory registration and regulation in the EU would be effective if it imposed upon CRAs costs for which issuers and investors would see insufficient benefit. This would ignore the global nature of the financial services industry and could lead the global CRAs to relocate their EU operations outside the EU, to Zurich or New York, while continuing to rate EU issuers. The EU based CRA's would not find their global credibility enhanced but would be obliged to take on the additional costs of EU regulation making it more difficult for them to compete with the global CRAs. In this environment, perhaps the only way for the EU to support local CRAs would be to <u>require</u> EU issuers to obtain a rating from an EU based CRA, which would impose additional costs on issuers to no obvious benefit since the rating would add little or nothing to investors perception of the credit-worthiness of the issuer or the security.

Do you think the IOSCO Code of Conduct is conducive to reducing or increasing competition?

As a freestanding Code, subject to implementation on a self-regulatory basis as set out in our comments on the previous question, we think that the Code will make a contribution to increasing competition in the provision of ratings. Smaller CRAs will be able to point to their compliance with the Code, where practical, as endorsed by their external auditors, which may increase their credibility among investors and thereby encourage their use by issuers.

However, we are strongly of the view that the best way to enhance global competition from which EU based CRAs would benefit would be for the US SEC either to give up its NRSRO regime or to open it up to additional CRAs on the basis of open and transparent criteria which are not weighted, as at present, to CRAs which already have a major presence and a high degree of acceptance among US investors.

Conversely, if the IOSCO Code was to be enforced in the EU by some form of statutory or statutorily endorsed regulation, that is any of options 1-4, we believe that the impact on competition would be negative. Applied to all CRAs it would impose a new barrier to entry or an unacceptably high level of additional cost on existing small CRAs. These problems could only be avoided if a lighter version of the code was imposed on new entrants and small CRAs. Not only would that be legally contentious, but also it would not give the small CRAs the credibility versus large CRAs with issuers and investors, which some of them appear to believe regulation/registration would provide.

Are there any areas where any European rules of conduct should be extended beyond the IOSCO Code?

No.

To what extent is a joint treatment of rating agencies by banking and securities regulators desirable?

We recognise that the use of external entities for the purposes of calculating regulatory capital raises different issues than in their use by investors. In the first, banks (and investment firms) will, in effect, be outsourcing a key part of their compliance function. Errors here could, in extreme cases, impact on the viability of the institution and potentially extend to negative systemic effects. Prudential regulators will rightly be concerned to minimise these risks. While standing alongside their colleagues in seeking to promote high standards within CRAs, they may therefore, properly, be less concerned to promote competition and choice for investors in the provision of credit ratings.

It follows, we believe, that there is no over-riding necessity for both groups of regulators to treat CRAs in the same way, even if close collaboration, avoidance of contradiction and the minimisation of differences of approach is highly desirable to minimise costs.

January 29, 2005