

Comments on the day-to-day application of the IOSCO Code by the Credit Rating Agencies (CRAs)

Summary

The German Insurance Association (GDV) considers globally recognised binding minimum standards for the business of CRAs as essential if both the quality of credit ratings and the efficiency of the rating process are to be maintained. Therefore, we fully support the new regulatory framework created with the publication of the IOSCO Code of Conduct Fundamentals for CRAs in 2004, and we very much welcome CESR's role in monitoring compliance with the IOSCO Code in the European Union.

In our view, the new IOSCO Code can be regarded as a major step forward towards dealing with prior significant concerns with respect to CRAs' actual business conduct and towards closing the regulatory gap which had previously existed in the rating market. Though it seems too early for a comprehensive judgement of the actual success of the Code in the market – whether it will be globally adhered to by CRAs and whether it will prove sufficient to ease all prior concerns – we believe that the experience so far has been promising. In the German insurance market, we have observed a significant improvement in CRAs' business conduct, e.g., with respect to transparency of rating methodology and interaction with market participants. However, some limitations of the Code have also become apparent already. Many Code provisions offer general guidelines only, and the wording is sometimes ambiguous. Hence, there is ample scope of interpretation, and in some cases the CRAs' interpretation of the Code's wording seems to contradict the original objectives of the Code. Moreover, as there is no external arbitration or enforcement mechanism, cases of disagreement between market participants and rating agencies over the interpretation of the Code – as is partly the case in a recent dispute between the GDV and Fitch – can hardly be resolved.

In sum, even though the overall experience of the impact of the IOSCO Code on CRAs business conduct is very promising, and even though we would not know of any single case of an open neglect of the Code provisions by any single CRA, some additional supervisory guidance on the interpretation of the Code provisions seems desirable. Moreover, in the course of the imminent review of the Code the wording of some Code provisions might have to be reconsidered in order to minimize potential disagreement over the actual meaning of these clauses. In addition, in order to further promote compliance with the Code, an external arbitration body might be established as an institution of appeal in case of disagreement between an issuer or investor and a CRA.

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On behalf of the German insurance industry, we would like to thank CESR for the opportunity to submit our comments on the day-to-day application of the IOSCO Code by the Credit Rating Agencies in response to the questionnaire published by CESR on 6th July 2006 (Ref: 06-312). The German Insurance Association (GDV) considers the implementation of globally recognised binding minimum standards for the business of CRAs as essential if both the quality of credit ratings and the efficiency of the rating process are to be maintained. Therefore, we fully support the new regulatory framework created with the publication of the IOSCO Code of Conduct Fundamentals for CRAs in 2004, and we very much welcome CESR's role in monitoring compliance with the IOSCO Code in the European Union. We really appreciate the valuable work which has already been undertaken by CESR in this field, and especially the possibility to take part in CESR's dialogue with both market participants and CRAs aiming at the publication of an annual report on the state of affairs with respect to the application of the IOSCO provisions in daily business. Therefore, as the trade association of the German insurance industry, we would like to offer to CESR any assistance with respect to CESR's new role in assessing adherence to the IOSCO Code for CRAs that might be required, and that we are able to provide.

Before commenting on CESR's questionnaire on the day-to-day application of the IOSCO Code by the Credit Rating Agencies, we would also like to provide some general assessment which might help to better understand our response to the actual questions.

Relevance of ratings for the German insurance industry

As the trade association of the German insurance industry with almost universal membership, the GDV represents 454 insurance companies (life, health, property/casualty and reinsurance) with total assets of some EUR 1,066 bn. Insurance companies rely on external ratings for several reasons. In their role as institutional investors, insurance companies make extensive use of ratings provided by CRAs in managing their asset portfolios. However, insurers are also confronted with the practices of CRAs in their role as issuers in the financial markets. Moreover, insurer financial strength ratings have an increasing impact on an insurer's standing in the market for insurance coverage. When contracting with reinsurance companies, direct insurers would typically look at reinsurers' financial strength ratings. In addition, a growing number of intermediaries or even policyholders also draw on ratings when advising on or taking out primary insurance, especially in the field of life insurance. Finally, ratings are increasingly referred to for regulatory purposes, for example, as a proxy of asset risk in stress testing or within the Basel II and potentially in the upcoming Solvency II framework. For all these reasons, the insurance industry depends crucially on high standards in the rating process and on the reliability and quality of the ratings issued by CRAs. Maintaining the quality of

rating assessments is an important prerequisite for a smooth functioning of financial markets and the stability of the financial system, not only in the case of the insurance industry.

The need for some regulatory framework for CRAs

Even though several incidents had provided examples of disagreement between the German insurance industry and CRAs over the methods and procedures applied and the standards used in the publication of rating assessments, we would like to emphasise that, in the view of our industry, even prior to the publication of the IOSCO Code, the quality of rating assessments and the working relation with CRAs could, in general, be characterised as largely satisfactory. However, we have been convinced that some regulatory framework would be essential if a sufficiently high quality both of rating assessments and the rating process was not to be put at risk. In our view, prior to the publication of the IOSCO Code, there was an urgent need for the creation of some globally recognised binding minimum standards for CRAs.

Traditionally, CRAs have been subject to hardly any formal regulation or supervision. Whereas other institutions or professions that are comparable in their importance to financial markets, e.g., auditors or actuaries, have had to adhere to a wealth of legal standards or professional codes for a long time, CRAs have traditionally claimed that in the rating industry competition or the vital importance of maintaining a good reputation in the markets would be sufficient in order to rule out any deviations or deficiencies with respect to high professional and quality standards whenever a rating assessment would be provided. In our view, there are many good reasons why this claim can hardly be maintained if scrutinised carefully. Rather, even leaving aside aspects such as human failure or the imperfections of institutions, because of the particularities of the rating market, which is characterised by potential conflicts of interest, a natural oligopoly, high barriers to market entry and informational asymmetries between producers and users of ratings, neither a high quality nor the integrity of the rating process can – contrary to the CRAs' traditional claim – be expected to be achieved entirely as a result of the forces of competition prevailing in the market. Therefore, if deviations from the desired levels of quality and integrity of the rating process were to be ruled out, some form of an external provision of binding minimum standards for the business of CRAs seemed necessary. In this respect, a self-regulation by the CRAs, which had all adopted internal codes of conduct prior to the publication of the IOSCO Code, had to be considered insufficient since it could never fully be relied on in order to guarantee adequate market results.

Assessment of the current regulatory framework

In our view, the IOSCO Code can be regarded as a major step forward towards closing the regulatory gap which had previously existed in the

rating market. With the introduction of globally binding minimum standards for CRAs with respect to transparency of the rating methodology, disclosure of the type of rating, dealing with conflicts of interest, quality and integrity of the rating process, and CRAs' interaction with rated entities, the Code provides a suitable framework for CRAs' activities. Since regulators have already announced further measures in case the current IOSCO framework should prove insufficient, and since any deviations, let alone an open neglect, of the provisions of the IOSCO Code will have a strong adverse effect on reputation for the respective CRA, incentives for CRAs to implement the Code provisions are substantial. In the European Union, CESR's new voluntary framework of co-operation between CESR and CRAs, and the monitoring and reporting function which has been assigned to CESR by the European Commission should further promote compliance with the IOSCO Code.

The actual success of the Code in the market – whether it will be globally adhered to by CRAs and whether it will prove sufficient to ease all prior concerns – can, very likely, only be judged upon after sufficient experience will have been gathered with the new Code. For this reason, we very much welcome the approach included both in CESR's advice to the European Commission and subsequently in the European Commission's Communication not to regulate the CRA industry any further for the time being, and, instead, to focus on the monitoring of market developments and CRAs' compliance with the IOSCO Code.

To the extent that the current regulatory framework for rating agencies might prove insufficient, however, further measures will be necessary. E.g., even though our overall experience of the impact of the IOSCO Code on CRAs' business conduct is very promising, and even though we would not know of any single case of an open neglect of the Code provisions by any single CRA, our experience provides distinct cases where disagreement between market participants and rating agencies over the interpretation of the Code could not be resolved. Therefore, some additional supervisory guidance on the interpretation of the Code provisions seems desirable. Moreover, in the course of the imminent review of the Code the wording of some Code provisions might have to be reconsidered in order to minimize potential disagreement over the actual meaning of these clauses. In addition, in order to further promote compliance with the Code, an external arbitration committee might be established for incidents in which no consensus can be reached between market participants and a CRA on whether a certain business practice applied by the CRA is actually consistent with the Code. On the other hand, beyond an amendment of the IOSCO Code, further regulatory measures would only seem inevitable if – in an extreme case – the rules and procedures of the Code were openly or intentionally violated by CRAs. However, it is our experience that this has not happened so far.

In addition, one important caveat applies. Any regulatory measures in the European Union that might be considered necessary would require a close co-ordination at international level and, in particular, with the U.S. Especially, the opportunities both of investors and issuers to use the full scope of global capital markets must not be affected if potential efficiency gains from improving on the work of CRAs are not to be offset by new restrictions on the functioning of global capital markets. Therefore, even if beyond an amendment of the IOSCO Code additional regulatory measures would be considered necessary, this should be the subject of further discussions at IOSCO level in the first place.

Impact of the IOSCO Code: General observations

With the IOSCO Code, for the first time rated entities and users of ratings can rely on certain standards which they can refer to whenever disagreement with a CRA occurs. Though it seems too early for a comprehensive judgement of the actual success of the Code in the market, we believe that the experience so far has been promising. In the German insurance market, it is our general impression that the publication of the IOSCO Code – supported by an increased level of attention paid by regulators and supervisors world-wide to the CRAs' activities – has led to substantial additional efforts by CRAs to improve on their business conduct. We do observe considerable efforts by CRAs to enhance their quality and transparency standards, and all major CRAs seem to have incorporated the IOSCO Code into their own codes of conduct by now, with only a limited number of deviations from the IOSCO provisions. We also experience an increased willingness by CRAs to enter into dialogue with the German insurance industry both with respect to rating methodology and procedures and practices. Moreover, a great deal of additional information on procedures and practices is now publicly available, and public consultations on changes in rating methodology have become by far more common as compared to the period prior to the publication of the IOSCO Code.

The effectiveness of the new regulatory framework was also highlighted in an interaction between the German insurance industry and Fitch with respect to the introduction of a new type of unsolicited ratings for a large number of German insurers. In December 2004, shortly before the publication of the IOSCO Code, with reference to the Code provisions, the GDV called on Fitch to amend its plans for the imminent assignment of quantitative IFS-ratings (so-called Q-ratings) claiming that Fitch's approach was in clear violation of several of the IOSCO Code provisions. Fitch responded to GDV's intervention, and major improvements could be achieved, in particular, a 3-month delay in the publication of Q-ratings, and, in the meantime, transparency of and a public consultation on the rating methodology, improvements in the interaction with rated entities, including an appeal process, as well as an unambiguous communication

by Fitch on the special character of Q-ratings upon publications.¹ The effectiveness of the new IOSCO Code became also apparent in a second interaction between the GDV and Fitch in the course of which the GDV made use of the new possibility provided by the IOSCO Code to submit a formal complaint to the respective CRA (see in more detail below).

Even though this overall assessment of the impact of the IOSCO Code in the German insurance market is very positive and even though we would not know of any single case of an open neglect of the Code provisions by any single CRA, some limitations of the IOSCO Code have, in our view, also become apparent already. Many provisions of the IOSCO Code contain general guidelines only, for example, with respect to transparency of methodology or prior notification of rated entities. In addition, the wording is often ambiguous (e.g., certain provisions apply “where feasible and appropriate” only). Therefore, there is ample scope of interpretation, and it is our experience that in some cases the CRAs’ interpretation of the Code’s wording seems to contradict the original objectives of the Code. Moreover, cases of disagreement between market participants and rating agencies over the interpretation of the Code – as is partly the case in the second dispute between the GDV and Fitch, which is referred to in more detail below – could not be resolved.

Case Study: GDV’s formal complaint to Fitch

The limitations of the current framework have become evident in a recent dispute between the GDV and Fitch, even though the results of this dispute can also be interpreted to a large extent as an additional piece of evidence for the positive impact of the IOSCO Code. For several years, besides the issue of Q-ratings, a large number of issues of concern with respect to Fitch’s activities in the German insurance market had been discussed between the GDV and Fitch. Since it had not been possible to achieve sufficient improvements in Fitch’s business conduct in the course of this ongoing informal dialogue, the GDV decided to submit a formal complaint with reference to the IOSCO Code provisions to Fitch, which was finally submitted in April 2006. The formal complaint focussed on the poor quality of market research published by Fitch on German life insurers, including the handling of market feedback on this research, insufficient disclosure of unsolicited ratings, and Fitch’s policies of prior notification of rated entities. In the complaint letter, the GDV referred both to general policies adhered to by Fitch and to a number of instances in which, in the view of the German insurance industry, Fitch did not (fully) comply with the IOSCO provisions. The complaint letter was supported by a comprehensive documentation of the Code violations referred to by the GDV.

¹ For further details on this interaction between the GDV and Fitch see the GDV’s letter of complaint of December 2004 and the GDV’s comment on Fitch’s Q-rating Exposure Draft, both available on the GDV’s Web site (www.gdv.de/fitch-q-rating). Information on the Q-ratings and Fitch’s consultation with the market is available on Fitch’s Web site (www.fitchratings.com).

Following the submission of the complaint, Fitch took the issue very seriously and carried out a thorough investigation on all the issues raised by the GDV. As a result of this investigation Fitch had to concede in its response to the GDV of 15th June 2006 that quite a number of shortcomings and errors had occurred in the course of its activities in the German insurance market. For example, Fitch admitted that there had been systematic miscalculations in its market research on the German life insurance industry, that there had been weaknesses in the handling of market feedback, that several of Fitch's own policies (e.g., on disclosure of ratings) had not been fully implemented in the German market, and that Fitch's communication with rated entities in the German insurance market had to be improved in the case of unsolicited ratings. Fitch simultaneously announced corrective action which had already been initiated to remedy the acknowledged shortcomings, and we expect Fitch's business conduct in the German insurance market to improve substantially as a result. In this regard, both the impact of the IOSCO Code and the effectiveness of the new complaint mechanism provided by the IOSCO Code can be viewed as extremely promising.

On the other hand, however, in its letter of response Fitch denied that its general policies on disclosure of unsolicited ratings or on prior notification of rated entities violated the IOSCO Code provisions as it had been claimed by the GDV in its letter of complaint. According to Fitch's own interpretation of the relevant IOSCO Code provisions, which differs markedly from that of the GDV, Fitch's approach fully complies with the IOSCO rules. Therefore, with respect to these two issues – disclosure of unsolicited ratings and prior notification – Fitch was not willing to carry out the changes to its policies which were requested by the GDV. Since both issues are explicitly asked for in CESR's questionnaire, the disagreement between the GDV and Fitch over the interpretation of the relevant provisions of the IOSCO Code is explained in more detail below.²

Special issues – selected comments on CESR's questionnaire

In addition to the general assessment provided so far, we would also like to comment in more detail on some of the questions raised by CESR in the questionnaire.

² For more details also cf. the GDV's formal complaint and Fitch's letter of response which are available on the GDV's Web site (www.gdv.de/fitch-gdv-complaint).

Question 8.1: Do you consider that the CRAs disclose clearly in the rating decision whether

- a. the rating was not initiated at the issuers request?**
- b. the issuer has not participated in the rating process?**

In our view, a clear and unequivocal distinction between different types of ratings with respect to their initiation and participation status as required by the IOSCO provisions must constitute an essential part of the CRAs' communication efforts in order to minimize misleading signals for market participants. Over the last few years, CRAs have undoubtedly improved their disclosure of the type of rating so that today more information on the initiation and participation status of a rating is publicly available. However, we believe that disclosure, in many cases, can still not be regarded as sufficient. Moreover, the question of disclosure of the type of rating has, in our experience, proved to be one of the most controversial issues in connection with the implementation of the IOSCO Code.

The IOSCO Code (provision 3.9) clearly stipulates that "for each rating, the CRA should disclose whether the issuer participated in the rating process" and that "each rating not initiated at the request of the issuer should be identified as such". It is our interpretation that the Code demands that CRAs disclose the type of rating at any time whenever a rating is published or quoted in public, for example, in rating reports, press releases, in tables displaying several ratings, in market reports or in all other publications by the CRA so that this information is readily available to any user of that rating. The type of rating should be immediately transparent, for example, in form of a subscript or a subscript and a footnote added to the rating. Moreover, in our view, the current procedure in some cases to assemble ratings of different types (e.g., purely quantitative ratings and traditional ratings or solicited and unsolicited ratings) in one single table should be thoroughly discussed and potentially be ruled out by the Code. In the German insurance market, several examples of full disclosure of the type of rating can be found, e.g., the "pi" notation applied by Standard & Poor's in order to disclose unsolicited insurer financial strength ratings or the subscript "q" used by Fitch in order to mark its Q-ratings, accompanied by a footnote to explain the special character of this type of rating. However, there are also examples that users of ratings have to go to some length in order to have access to the desired information, or that the information is not made available to users of ratings at all.

The question of disclosure of the type of rating was one of the major issues in the above mentioned dispute between the GDV and Fitch. A resolution of the disagreement on this issue has proved impossible so far. Fitch's policy is to only disclose the information required by the IOSCO Code at the time of the assignment or revision of a rating as part of the initial press release which is publicly available for a period of only about

7 days after publication on Fitch's Web site. After that period, Fitch would continue to publish that rating, however, without any further disclosure of the type of rating. Instead, a reference on Fitch's Web site informs users of ratings about the possibility to contact a rating desk in order to inquire about the initiation or participation status of any rating published by Fitch. We do not hold any evidence that the relevant information has not been made available by Fitch upon request. Still, in our view, this disclosure policy is not sufficient and constitutes a violation of the provisions of the IOSCO Code since the disclosure of the type of rating should be self-explanatory at any time. Requiring users of ratings to contact Fitch whenever they want to receive additional information on the type of a rating can be viewed as a major impediment to the use of this information in market participants' decisions. Moreover, since Fitch's ratings have often been published without any indication about the possibility to receive additional information on the rating type upon request, users of ratings might not even be aware of the fact that, e.g., they rely on an unsolicited rating.

Beside this policy by Fitch, which in our view is in clear violation of the provisions of the IOSCO Code, some shortcomings can also be observed in the policies adhered to by other CRAs in the German insurance market. E.g., Standard & Poor's, which clearly discloses unsolicited ratings with the "pi" notation, does not give any additional information on the rated entity's participation. Moody's is providing that information, however, only in the form of a separate report on its Web site so that the information is not immediately accessible to users of ratings either, even more so since in other publications by Moody's there is often no indication that a rating might be non-participating.³

Question 8.2: Is the abovementioned disclosure valuable for you?

Full disclosure on initiation and participation status of a rating is, from the German insurance industry's point of view, essential in order to avoid distortions both in the financial markets and in the market for ratings. Even though unsolicited or non-participating ratings can clearly play a useful role in the financial markets and help investors in their investment decisions, both have to be clearly distinguished from solicited fully interactive ratings. As several studies have shown, rating assessments will differ systematically according to the different types of ratings.⁴ For example, there seems to be a bias towards a more prudent assessment and hence lower ratings in the case of unsolicited ratings due to the generally lower level of information incorporated since unsolicited ratings are usually prepared without access to (in-depth) non-public information.

³ According to Moody's, no new agency-initiated ratings are currently assigned in the German insurance market. Therefore, this criticism only applies to unsolicited ratings assigned earlier, and eventually it might lose its relevance at all.

⁴ See, for example, Van Roy, Patrick (2006): Is there a difference between solicited and unsolicited bank ratings and if so, why? National Bank of Belgium Working paper no. 79.

We believe that users of ratings should be afforded with the possibility to take the type of rating into account in order to prevent potential biases in the rating assessment from spilling over to distortions in the investment decisions of market participants. For this reason, full transparency on the type of rating is essential. Moreover, if unsolicited and hence inferior ratings are displayed by CRAs to investors without making the distinction with respect to solicited ratings fully transparent issuers might feel exposed to an undue pressure with respect to the decision on entering into a solicited and fully interactive rating process in order to avoid disadvantages in the market. This observation, which is usually denied by CRAs, provides an additional argument in favour of full transparency of the type of rating at any time.

Question 8.3: Do you know of cases where ratings of the type mentioned above (a and b) had a lower degree of quality than others?

As the quality of a rating clearly depends on the amount of information available in the rating process, the quality of unsolicited and non-participating ratings should be generally lower than that of solicited and fully participating ratings. Even if – in the case of an unsolicited rating – the issuer might provide some internal information, the amount of information which the CRA can rely on for the rating assessment will generally be lower than in the case of a solicited fully interactive rating. Therefore, information on the initiation and participation status of a rating provides an important orientation for investors in order to distinguish between the various types of ratings in terms of their quality.

Question 9: Have you ever experienced (or heard about) situations where the CRA has denied the issuer the opportunity to clarify any likely factual misperceptions or other matters that the CRA should be aware of prior to issuing or revising the rating?

From the German insurance industry's point of view, it is of great importance that CRAs afford rated entities the opportunity to get to know the respective rating outcome and the key elements underlying that rating decision beforehand, and to comment on the decision and the rating commentary prior to publication. This procedure is in the mutual interest of investors, issuers and CRAs, since any misperceptions or a flawed interpretation of information by the CRA can be avoided, and investors can rely on the quality of the rating results. We believe that, especially from the investors' perspective, the timeliness of publication must always be balanced against the quality of ratings, and that a reasonable opportunity for the issuers to respond should be granted unless in exceptional circumstances (e.g., in the case of exceptional breaking news) there are compelling reasons for an immediate publication of the rating assessment, especially in the case of the revision of a rating.

The IOSCO Code clearly states that a prior notification of the rated entity of the rating result and the critical information and principal considerations upon which a rating is based is required, and that the rated entity should be afforded the opportunity to “clarify any likely factual misperceptions or other matters that the CRA would wish to be made aware of in order to produce an accurate rating”. However, there is some scope of interpretation since the IOSCO Code restricts the application of that rule to cases “where feasible and appropriate”. Moreover, the Code does not specify any notification period, even though it is obvious that an extremely short notification period of a few hours or even a few minutes only would be tantamount to a factual denial of the opportunity for the rated entity to provide further information or to engage in a formal appeal process.

It is our impression that there have been substantial improvements in the interaction between CRAs and rated entities in the German insurance market, including the issue of prior notification. However, at present, there is no guarantee that CRAs will always take this provision of the IOSCO Code into account since they could always claim that, in their view, in a particular case this had not been “feasible” or “appropriate”. Moreover, there is no guarantee that the amount of time between prior notification and publication of the rating will actually be sufficient in order to enable the rated entity to provide additional information. The question of the response time granted to the rated entity was the second major issue in the GDV’s dispute with Fitch where an agreement over the interpretation of the Code provisions could not be reached. Fitch’s own code of conduct states that “in no case may an issuer, as part of the issuer’s review, hold the commentary to beyond the close of business on the day Fitch provides it” (provision 2.3). This means that rated entities generally have to react to Fitch’s prior notification within a maximum of one full business day, whereas a minimum period is not specified any further. In our view, this specification in Fitch’s own code of conduct can hardly be viewed to be consistent with the IOSCO Code since the rated entity would often not have sufficient time for reviewing the rating commentary, especially when the rating is unsolicited and the rated entity might not even be aware of an imminent notification by Fitch. In the latter case, no arrangements can be made in order to be able to react in time, and in the worst case, the notification might even not be properly addressed to the staff in charge of ratings within that company, so that the prior notification is purely formal and has no implications for the maintenance of certain quality standards of rating assessments.

In our formal complaint to Fitch of April 2006, we provided evidence on the case of a German insurance company which was de facto denied the possibility of a review in the context of an unsolicited rating to be published or updated by Fitch since the notification period granted to that company by Fitch amounted to a few hours only and in one instance even less than 2 hours. As a result, various press releases published by Fitch contained factual errors which had to be conceded by Fitch later on, and market par-

ticipants were provided with information of inferior quality several times. Even though no amount of time for the notification period is specified in the IOSCO Code we believe that this example of Fitch's business conduct cannot be regarded to be consistent with the provisions of the IOSCO Code since Fitch, as a result of the extremely short notification period, has not provided the issuer with a factual opportunity to clarify errors or misperceptions.⁵

Question 14: Have you encountered any problems in relation to the use of confidential information in your day-to-day business with CRAs?

The confidentiality of information is a critical issue in discussions between market participants and CRAs in the case of unsolicited ratings. CRAs often provide rated entities with the opportunity to make additional internal information available prior to an unsolicited rating in order to allow for a more accurate rating assessment. In general, we welcome this approach since the quality of unsolicited ratings can be substantially improved when additional information is taken into account. However, CRAs are very often not willing to guarantee that the confidentiality of this internal information will be respected, so that issuers are exposed to a difficult dilemma between publicly releasing confidential information and risking an inferior unsolicited rating.

In the German insurance market, both Fitch (in the case of Q-ratings) and Standard & Poor's (in the case of pi-ratings) regularly invite German insurers to provide additional internal information as an input to the rating process. However, all the information made available by the companies concerned is then regarded as public information by the CRAs. We believe that this procedure can be a major impediment to the provision of internal information since many companies might not want to make relevant information publicly available. What is more, companies may face the dilemma to either accept a rating on the basis of market assumptions that do not concur with their individual situation, which might lead to an inaccurate rating assessment, or to risk internal information to become public. Therefore, some form of automatic confidentiality protection for internal information made available to CRAs might be considered as an additional provision for the business conduct of CRAs in the course of the imminent review of the IOSCO Code.

In addition, the protection of confidential information is also an important issue in the case of solicited ratings where rated entities usually afford the CRA with a wealth of internal information. In order to protect the confidentiality of this information, confidentiality agreements are signed by the CRAs, and the CRAs have established procedures and mechanisms for

⁵ For more detailed information on this case see the GDV's letter of complaint and Fitch's response letter, both available under www.gdv.de/fitch-gdv-complaint.

the treatment of internal information as required by the IOSCO provisions. Although so far we do not hold any evidence from the German insurance market that internal information was misused, there is some concern among German insurers that standards for confidentiality protection might not always be fully adhered to in daily business, for example, due to time pressure (e.g., use of e-mail correspondence including internal information without password protection).

Berlin, 25th August 2006