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Comments by the HVB Group on the Call to CESR for Technical Advice on Possible Measures concerning Credit Rating Agencies - Published by the Committee of European Securities Regulators (CESR) on July 28, 2004

Dear Mr. Demarigny,

Our standpoint with regard to the above-mentioned CESR Call for Evidence in connection with rating agencies is as follows:

1. Problems

As we all know, a number of problems are involved with the growing significance of rating agencies:

- Oligopolistic market structures with only a few large agencies, no real competition, stiff restrictions on competition for additional providers
- Lack of transparency, reasons for the decisions made by rating agencies for third parties (investors, analysts and others) are difficult to follow. Important for investors and their investment decisions, however, is on what information the rating assessment is based. It is equally important for the companies rated to be able to understand the factors on which a rating is based.
- Conflicts of interest may exist if the rating agency and the company concerned are integrated or if there are additional rating mandates or financial dependencies in connection with large-scale mandates. The same applies if companies have interlocking boards.
- Dealing with insider information and price manipulation, observing confidentiality

- Lack of judicial norms and defined monitoring units for rating tasks.

2. Proposal for a solution

In our opinion, the right approach would be the development of a Code of Conduct for Rating Agencies, since we consider statutory regulations at the EU level too inflexible and do not believe they can be enforced internationally.

In line with and supplementary to the regulatory requirements for rating agencies contained in Basel II implementation (Annex C-2 of the implementation of Basel II in EU law) other industry standards (in the form of a Code of Conduct) could be developed and "seals of approval" could be awarded to rating agencies on this basis.

A Code of Conduct should cover the following points:

- Disclosure of assumptions and methods on which the final rating is based

The assumptions and criteria on which the different ratings are based should be transparent and comprehensible for the issuer. (This is also requested in the IRB approach contained in Basel II and should thus be applied to external ratings as well). This includes disclosure of the methods, documentation and thus comprehensibility of the decision of the rating committee. Regulating the rating methods, in contrast, does not appear wise since here too, competition can only lead to better decisions.

To ensure fair presentation of rating results, the issuer should be able to comment on the rating before it is made public.

Basic methods should also be discussed with the companies involved and sufficient time should be given for preparation.

- Ensuring quality of the ratings by setting standards for rating specialists' qualifications

Important success factors for the quality of ratings are qualification, competence and experience of those in charge of ratings. General requirements for this should be included in a Code of Conduct. This also applies to the composition of a rating team. Frequently members do not have the legal knowledge necessary to judge the complex regulatory environment.

- Disclosure of consulting mandates in the event of simultaneous mandating for rating and/or other dependencies

Since rating agencies also act as consultants prior to transactions and for other purposes there is a risk that rating and consulting will influence each other. The agencies should therefore disclose their consulting mandates and any dependencies.

- Conflicts of interest: Links between rating agencies and rated companies

Links between the rated companies and the rating agency which could lead to conflicts of interest and other potential conflicts should be disclosed.

- Self-commitment of those responsible for ratings not to hold stocks of rated companies and banks or, if they hold stocks, to disclose such holdings
- Obligations in connection with dealing with insider information

Whether or not to pass on confidential data is a matter for the issuer to decide. Thus harmonization should not require that information be disclosed to rating agencies which was previously confidential.

If confidential information is disclosed, corresponding regulations should be developed to govern dealing with insider information.

- **Distinguishing ratings which have not been ordered**

Third parties should be able to distinguish ratings which have not been ordered from those which have been ordered. because ratings which have not been ordered are not based on the same information. Moreover, they should not be the basis for regulatory ratings.

- Establishing a voluntary arbitration board

It might be wise to set up an arbitration board which would enable issuers to discuss questions under dispute with the agencies and other experts and reach an amicable decision.

- Monitoring and sanctioning violations of the Code of Conduct

A Code of Conduct which cannot be monitored or violation of which cannot be sanctioned, is doomed to failure from the start. A government agency could be responsible for enforcing the Codex. The Code should be interpreted and monitored in a uniform manner worldwide, for example through CESR. A two-stage procedure is also conceivable such as was established recently for enforcing financial reporting standards: A private institution first monitors observation of the Code of Conduct. then if necessary sanctions can be applied by a state institutions. A sanction could take the form of making violations known publicly or proceeding according to the "comply or explain" principle.

These and possibly other questions should be regulated in a Code of Conduct in such a way as to ensure fair dealing between rating agencies and issuers without impairing the rating agencies' independence.

Sincerely yours,

Bayerische Hypo- und Vereinsbank AG

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