IMMFA
Institutional Money Market Funds Association

31 March 2008

CESR
11-13 avenue d Friedland
Paris
France 75008

Dear Sirs

The role of credit rating agencies in structured finance

The Institutional Money Market Funds Association (IMMFA) are grateful for the opportunity to provide comments on the consultation paper on the role of credit rating agencies (CRAs) in structured finance.

IMMFA is the trade association representing the promoters of triple-A rated money market funds[1] and covers nearly all of the major promoters of this type of fund outside the US. Money market funds are brought primarily by institutions to manage their liquidity positions and not for 'total-return' investment purposes. They are used as an alternative to wholesale money market deposits by a wide range of investor types as they offer a practical means of consolidating and outsourcing short-term investment of cash. Total assets in IMMFA members' funds as at March 2008 were in excess of €390 billion. You may obtain more information on triple-A rated money market funds from our website, www.immfa.org.

Our members all operate triple-A rated money market funds. One of the requirements which permit the maintenance of a triple-A rating is that the funds must only invest in assets which are themselves rated. Consequently, our members are very aware of the limitations of the ratings provided by the CRAs and familiar with the issues inherent in the business models of the CRAs.

We recognise that the opinion of the CRA should be only one element of the decision to invest in an instrument. However, we have noticed that there is an increased reliance placed by investors other than money market funds on the rating assigned to a particular instrument. Furthermore, with the implementation of the Capital Requirements Directive, which requires financial institutions to utilise the rating of a CRA in the calculation of the capital resources requirement for the firm, there has been even more acceptance without question.

[1] References in this letter to money market funds relates to those funds which comply with the CESR guidance on eligible assets for investments by UCITS, specifically the second bullet point of section 4(2). These funds are also known as '422 funds'.

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The events which have occurred since the summer of 2007 have resulted in a loss of confidence in the ratings of the CRAs. It is imperative that this confidence is restored if the integrity of the CRAs is to be maintained and the prudential regime for financial institutions is able to continue to rely upon the opinions of the CRAs.

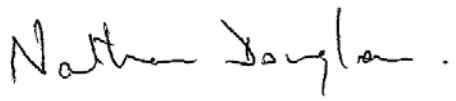
To this end, we note that the current regime which largely requires self-certification with the IOSCO Code has not proved sufficiently robust to prevent the crystallisation of risks within the CRAs. There is now a compelling argument for the introduction of regulation of CRAs. However, we recognise the costs associated with the introduction of regulation, and therefore would advocate that regulation should not be introduced which governs all activities of the CRAs. Instead, regulation should be introduced which addresses those risks within the CRAs which have failed to be mitigated by the current regime. The analysis which has been conducted within the consultation paper recognises the issues in relation to conflicts of interest, resourcing and transparency. We consider that conduct of business regulation covering these areas would address the issues which have arisen.

We do not consider that product regulation for CRAs should be introduced. Any regulatory framework in this area would not be sufficiently flexible to change and adapt to the innovation inherent within the market. Consequently, product regulation for CRAs could stifle innovation and should not therefore be introduced.

The consultation paper questions whether greater transparency would be a solution to a number of issues. We do not consider that greater transparency is the solution to every problem. To improve transparency in all areas would result in the provision of such volumes of information that the average investor could not reasonably be able to analyse and interpret. Consequently, there would again be an increased risk of reliance being placed on ratings without sufficient independent analysis being conducted by the investor. We advocate instead that the introduction of conduct of business regulation would provide the investor with the necessary reassurances that the CRA was operating in accordance with generally accepted minimum standards, without the need for disclosure of every detail of the CRAs business.

Our specific answers to the questions raised within the consultation paper are attached. We would welcome the opportunity to discuss these issues with you in more detail.

Yours faithfully



Nathan Douglas
IMMFA Secretariat

IMMFA response

The role of credit rating agencies in structured finance

Q1: Do you agree that the CRAs need to make greater on-going efforts to clarify the limitations of their ratings?

We are broadly supportive of this initiative, although our members – who all operate triple-A rated money market funds – are fully aware of the limitations of a rating. However, the events since August 2007 have indicated the reliance placed by investors on the ratings provided by the CRAs. There has to be an acceptance by some investors that understanding of the scope and nature of the rating provided was not appreciated in its totality. The task of the CRAs now is to ensure that investors utilising a rating fully understand and appreciate the limitations of the rating. This should be done not through greater clarification of the limitations, but more education of investors on the exact nature of the opinion being expressed through the rating.

Q2: Do you agree with CESR's view that although there has been improvement in transparency of methodologies, the accessibility and content of this information for complex structured finance products requires further improvements in particular so that investors have the information needed for them to judge the impact of market disruption on the volatility of the ratings?

We would suggest that the failure of the current mechanisms was an indicator that the level of information available to all investors was not sufficient. Whilst there have been attempts to improve the transparency of methodologies, additional transparency will prove beneficial for all investors in the market.

Q3: Do you agree that there needs to be greater transparency regarding the specific methodology used to determine individual structured finance ratings as well as rating reviews?

As above, we would suggest that an improvement in the transparency of the CRAs in this regard would prove beneficial to all investors in the market.

Q4: Do you agree that there needs to be greater public and standardised information on structured products in the EU? How would this best be achieved?

Standardisation of the information which is available will be of benefit to investors, as this will allow easier interpretation and analysis. To this end, we support the European Securitisation Forum's (ESF) report to the EU Commission on the subject of standardisation of data.

Q5: Do you agree with CESR that contractually set public announcements on structured finance performance would not add sufficient value to the market to justify the cost and possible saturation of the market with non-material information?

We agree that requiring contractually set public announcements could result in the saturation of the market with information which would not necessarily prove useful. The provision of information should coincide with an event which necessitates the release of information which ultimately proves beneficial to the end investor. This does not necessarily occur on a regular basis, and therefore we would not support a pre-determined release of information.

Q6: Do you agree that the monitoring of structured finance products presents significant challenges, and therefore should be a specific area of oversight going forward? Are there any particular steps that CRAs should take to ensure the timely monitoring of complex transactions?

The monitoring of structured finance is significantly different to the other activities of the CRAs to warrant a specific team dedicated to this activity. The events since summer 2007 have indicated the increased reliance which is placed upon the ratings of the CRAs – not least as a result of the implementation of the Capital Requirements Directive across Europe, whereby financial institutions are required to obtain and utilise the ratings of a CRA in the calculation of the firm's capital requirements.

The monitoring of ratings should be proactive. However, the ability to conduct such proactive monitoring will be reliant upon the CRA having sufficient human resources to be able to adequately monitor and reflect on market activity and review existing ratings. Consistent with our response to the CESR questionnaire of June 2007, we would suggest that the resources available to CRAs to monitor structured finance ratings was not sufficient.

We would also suggest that the CRAs should monitor the robustness of pricing methodologies for securities that they rate, and this factor should be considered in the rating which is assigned. It is crucial for potential investors to understand the pricing methodology used, and this is clearly one area which failed in the current crisis.

Q7: Do you believe that the CRAs have maintained sufficient human resource, both in terms of quality and quantity, to adequately deal with the volumes of business they have been carrying out, particularly with respect to structured finance business?

Given the significant growth which has been experienced in the availability and use of structured finance, we are of the opinion that it would be difficult for the CRAs to ensure there was sufficient resource and experience to deal effectively with the demand for ratings. This has been supported by the events since the summer of 2007, whereby we have seen rapid and wholesale changes in ratings, often with little indication of the occurrence of such events.

Q8: Do you consider that the generally unaltered educational and professional requirements of CRAs' recruitment policies negatively impact the quality of their rating process, given the rising complexity of structured finance products?

In a rapidly changing and evolving market, there is a need to ensure that the CRAs keep pace with the development through the updating of internal procedures to reflect the nature of the market. We consider that to have generally unaltered educational and professional requirements does not reflect positively on the CRAs.

Q9: Do you agree there is a need for greater transparency in terms of CRA resourcing?

Whilst we agree that there is a need for improvements in the resourcing of CRAs, we do not consider it to be a necessity for this information to be disclosed. There are more prudent areas in which enhancements to transparency would prove beneficial. To require transparency with regard to the resourcing of the CRA could result in an information overload, with the investor being inundated with information and unable to differentiate between that which is relevant and that which is not.

We would suggest that regulation of the conduct of business of the CRAs would be a means through which to ensure there was adequate resourcing of CRAs. Such regulation would not then require the disclosure of this information, but would provide the investor with reassurance that the CRAs were operating in accordance with prescribed obligations.

Q10: Do you agree with CESR that more clarity and greater independence is required for analyst remuneration at the CRAs?

See our response to Question 9. Conduct of business regulation could ensure that an potential conflict of interest were managed without the need for such information to be disclosed to the market.

Q11: Do you see the level of interaction between the CRAs and issuers of structured finance products creating additional conflicts of interest for the CRAs to those outlined above? Do you believe that any of these conflicts are not being managed properly?

We agree with CESR that the interaction between the CRAs and the issuers of structured finance products creates a conflict of interest as outlined in the consultation paper. With the increased demand for ratings in relation to structured finance products, the CRAs have seen an increased proportion of fee generation related to this area when compared with the other areas of business in which the CRAs operate.

This potential conflict of interest must be addressed to mitigate the possibility of the conflict materialising. To this end, we advocate that conduct of business regulation, which would

address conflicts of interest, would be the means through which to ensure that CRAs were managing any potential conflicts inherent within their business models.

Q12: Do you agree that greater transparency is required regarding the nature of interaction between CRAs and issuers/arrangers with regards to structured finance products and that there needs to be clearer definitions of acceptable practice?

We would support proposals to introduce conduct of business regulation which would outline standards of practice to which the CRAs must adhere. This would ensure that acceptable standards were introduced to ensure that the interaction between the CRAs and the issuers/arrangers was managed, and provide the investor with reassurance about the minimum standards with which the CRAs must comply. Furthermore, this would not require improvements in transparency. The investor would not therefore be inundated with unnecessary information, and could concentrate on analysing only that information which directly related to the rating of the structured finance product in question.

Q13: Do you believe there needs to be greater disclosure by CRAs over what they consider to be ancillary and core rating business?

Standardisation of terminology here would prove beneficial to investors. This could be achieved through conduct of business regulation, which would not then necessitate greater transparency in the market.

Q14: Do you believe that the fee model used for structured finance products creates a conflict of interest for the CRAs? If yes, is this conflict of interest being managed appropriately by the CRAs?

We agree that the fee models used have the potential to generate a conflict of interest. The market has placed increased reliance upon triple-A ratings, which has driven issuers to seek higher ratings for their products being rated, and with a consequent increase in fee generation for the CRAs. This conflict of interest must be managed appropriately; we consider that the events since the summer of 2007 are an indicator that this potential conflict of interest has not been adequately managed.

Q15: Do you agree with CESR that there needs to be greater disclosure of fee structures and practices with particular regard to structured finance ratings so as to mitigate potential conflicts of interest?

We agree that there should be greater transparency of fee structures to enable users to better understand the calculation of the fees being charged.

Q16: Do you agree with CESR's view of the benefits and costs of the current regime?

We agree with the analysis which has been conducted by CESR. However, we would point out the failures within the market, and specifically those driven by the reliance placed upon the ratings of the CRAs, as being a notable failure of the current regime. As such, we would question whether the market can continue to function without formal regulation of the CRAs. The self-certified compliance within this environment has not been sufficient to prevent the failure of the current regime, and the loss of confidence in the ratings assigned by the CRAs. Action must be taken to rectify this situation, particularly given the increased reliance which is placed on ratings of CRAs within the prudential regime for financial institutions.

Q17: Do you agree that CESR has correctly identified the likely benefits and costs related to formal regulatory action?

See below.

Q18: Do you believe that the current self-regulatory regime for CRAs should be maintained rather than introducing some form of formal recognition/regulation?

We would suggest that there is now a comprehensive argument in favour of regulation of CRAs. The failures in the market which have occurred since the summer of 2007 have to some extend been due to reliance placed upon the ratings of the CRAs. The CRAs, whilst compliant with a self-certified Code, have been unable to adapt to changing market conditions and developments.

We recognise the costs associated with the introduction of formal regulation. However, we do not advocate that regulation of all activities of the CRAs is necessary. Specifically, we do not believe that product regulation should be implemented. This would not be sufficiently flexible to keep pace with market developments.

Any regulation introduced should only govern the conduct of business of the CRAs. This would ensure conflicts of interest were adequately managed, would ensure CRAs maintained sufficient resources to conduct relevant activities, and would enable improvements to be made in transparency of those areas which would be of most relevance to investors. We do not consider that such high level obligations would create significant costs to the CRAs when compared to the benefits which would be derived from them, including the restoration of confidence in the ratings provided.

The current regime of self-certification has not prevented the failures which have occurred since the summer of 2007. Consequently, we consider that a formal regulatory regime should be introduced; however, this must not restrict innovation within the market and should be sufficiently flexible to allow the CRAs to adapt to and reflect the dynamic nature of the structured finance markets.