

June 17, 2010

Website Submission: www.cesr.eu

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

**Re: CESR Consultation Paper “Guidance on Common Standards for Assessment of Compliance of Credit Rating Methodologies with the Requirements set out in Article 8(3)”
Comments from Fitch Ratings (“Fitch”)**

Dear Mr Comporti,

We are writing in response to the invitation of the Committee of European Securities Regulators (“CESR”) to all interested parties to submit views with respect to the proposed approach outlined in the above referenced Consultation Paper (“the Consultation Paper”). For the convenience of CESR, we have provided our responses using the section heading and paragraph numbering employed within the Consultation Paper. We have only provided comments on those paragraphs with respect to which we have specific remarks. All of our Comments relate to proposed guidance contained within Section II of the Consultation Paper – Guidance on Common Standards for Assessment of Compliance of Credit Rating Methodologies.

Section II, Sub-section 1 – General Remarks

Paragraph 6: We note the instruction that “...this guidance should be read in conjunction with CESR’s guidance on the information set out in Annex II...”. We do not understand the intention of this statement. If the aim is to ensure that the reader understands that some of the general remarks with respect to Annex II, as published within “CESR’s Guidance on Registration Process, Functioning of Colleges, Mediation

Protocol, Information set out in Annex II, Information set out for the application for Certification and for the assessment of CRAs systemic importance” on June 4, 2010, would also be applicable with respect to this guidance, we suggest it would be clearer if CESR were simply to include the relevant paragraphs in both documents. If, alternatively, the intention is to use this new Consultation Document as a supplement to the finalised Annex II guidance document, we would have strong concerns. The guidance in this Consultation Paper is not scheduled to be finalised until the final day on which registration applications must be filed by existing credit rating agencies. As such, it would seem unreasonable to expect credit rating agencies to additionally address all of the Consultation Paper’s proposals in applications that are being finalised now.

Section II, Sub-section 2 – Scope of the Guidance

Paragraph 12: We note that the Consultation Paper proposes that credit rating agencies “...notify competent authorities of any material changes in their rating methodologies (either global or on a specific asset class) and related analytical documentation including rating factors, criteria and/or parametric assumptions...”. There is a distinction between a material change to a methodology – which could represent a major departure from the current approach, but impact relatively few ratings – and a change that has a material impact – say, for example, in terms of the number of affected ratings. We assume that CESR’s interest is in the latter type of change, but would welcome greater clarity on this. On a separate topic, we note a typing error in the bracketed section of this paragraph – reference is made to “loan given default” rather than “loss given default”.

Section II, Sub-section 4 – Detailed Information

We have a number of comments with respect to this section. First, the opening paragraph of Section A makes explicit reference to “due diligence”. As explained to CESR previously, Fitch does not believe this to be an appropriate term to use with respect to credit rating agencies. Credit rating agencies are not auditors. Indeed, neither Fitch nor, to the best of our knowledge, any other global credit rating agency conducts due diligence on any data provided to us from any third party, including, without limitation, the rated entity. Our business is the provision of forward looking credit opinions, based on an analysis of information provided to us by sources we believe to be reliable, and it is very important to us that users of our ratings understand clearly what we do. We therefore urge CESR not to use language in its guidance that could leave readers confused regarding our role.

Second, we note that the opening paragraph of Section A also states that credit rating agencies must demonstrate that “[t]he qualifications of credit rating analysts developing and reviewing methodologies are suitable for the task...”. Paragraph 15(f) also states that credit rating agencies should demonstrate that “[m]ethodologies are developed and reviewed by staff with appropriate qualifications, experience and expertise...”. We agree fully that credit rating agencies should use staff with the appropriate skill sets for the tasks they are assigned. Indeed, this principle is reflected in Fitch’s Code of Conduct. However, we would strongly object to any suggestion, as seems to be implied by the opening paragraph of Section A, and by the use of “and” rather than “and/or” in paragraph 15(f), that any assessment of suitability be focused on academic qualifications. While the vast majority of Fitch analysts are university educated, we have a limited number of staff that have gained experience and/or professional credentials via apprenticeships, financial industry programmes and internal training programmes typically provided by major financial organisations. We believe these staff to be fully qualified to work in analytical roles, including those relating to the development of methodologies, and that they bring a valuable perspective to our internal analytical discussions. We note that, in contrast to the opening paragraph of Section A and paragraph 15(f), paragraph 15(c) of the Consultation Paper refers instead to staff that have “...sufficient experience and relevant background to understand the complexities of rating methodologies”. We suggest this language is more appropriate. We also believe that this is consistent with Article 7(1) of the

Regulation, which requires credit rating agencies to use staff with “...appropriate knowledge and experience for the duties assigned”.

Third, we are concerned that much of the content of paragraphs 15 and 16 appears to imply that CESR expects credit rating agencies to organize themselves in a certain manner, and to adopt and apply methodologies that work in a certain way. One example is paragraph 15(a), which requires that credit rating agencies demonstrate that “[t]hey have appropriate controls in place between staff developing and updating rating methodologies and those responsible for issuing and monitoring ratings”. While Fitch has an independent review function in place with respect to its methodologies, we do not consider it necessary, or appropriate, to exclude our rating analysts from participating in the development of our rating methodologies. Indeed, we do not believe it would be sensible to develop methodologies without input from the analytical line since these are the staff that are most familiar with the data and developments within their sectors.

Another example is Paragraph 16(c), which refers to the “weightings of qualitative and quantitative factors within methodologies” as well as “the weightings of specific methodologies and their respective impact on the final rating”. Fitch does not apply its methodologies in such a rigid, formulaic way, nor would we think it appropriate to do so. Our methodology and criteria reports set out clearly the key factors that we consider in determining our ratings, but our ratings are determined by a rating committee, not a mathematical model. As such, it is not correct to assume that each rating factor is assigned a specific weighting since a key part of our analysis is how different factors interact. By way of example, two companies with equal, and relatively high, debt to equity ratios may exhibit very different levels of creditworthiness on account of the interplay of other factors – the maturity profile of the debt, access to sources of liquidity, the company’s stage in its life cycle, what the debt is being used for, and so on.

Another example of a tension between CESR’s expectations and credit rating agency practices relates to paragraph 16(d) concerning “[w]ritten procedures on how the CRA assesses if it has sufficiently reliable data to provide a credit rating...”. Fitch’s Code of Conduct makes clear that it will not assign or maintain any rating unless it has sufficient information to do so. It also makes clear that Fitch will “adopt reasonable measures so that the information it uses in assigning a rating is of sufficient quality to support a credible rating.” However, while our analytical groups have certain pre-determined minimum standards that they employ, it is very difficult to draft a policy that will address every possible combination of data that will be acceptable in advance – such decisions must be taken on a case-by-case basis. It is also important that Fitch retains the flexibility to react to economic and financial events, which could render it necessary to request additional or different data to what was previously considered necessary to conduct our analysis.

Paragraph 16(h) concerning the criteria and assumptions and rating volatility is another example of an issue that is more appropriately addressed on a case by case basis, rather than in a generic manner. In addition, while Fitch has policies regarding the development, amendment and withdrawal of its methodologies, as discussed in Paragraph 20(d), the suspension of a methodology is a rare event, which we consider would be more appropriately considered and managed on a case-by-case basis. On the same topic, we note that paragraph 20(f) refers to “[w]ritten procedures and documentation, test plans and test scenarios as well as other procedures for addressing unforeseen events in an emergency to allow for the continuous assessment of rating methodologies”. We do not understand the intention of this paragraph, or how it differs from paragraph 20(d).

Finally on this topic, we also note that paragraph 16(m) refers to the provision of information on “the extent of contacts with the senior management of the rated entities”. Fitch has contact with the senior management of the majority of the entities we rate, and we have no objection in providing competent authorities with this information. However, we would hope that this is not an indication that CESR

expects such interaction to occur in all cases. We note that such an expectation would be inconsistent with the provisions of Article 10(5) of the EU Regulation. Fitch maintains a number of ratings without the direct participation of the entity. In all such cases, we disclose the fact that the issuer does not participate in the rating process in our Rating Action Commentaries and issuer-specific research reports. We do not assign or maintain any rating unless we have access to sufficient information to do so. This is true for both participatory and non-participatory ratings.

Fourth, we note that paragraph 15(d) makes reference to methodologies being developed and reviewed with “...appropriate access to all the information required to acquire a clear understanding of all factors relevant to the credit rating methodology...”. A similar concept regarding the sufficiency of information is also included in Paragraph 15(b). As stated above, the same concept is included in Fitch’s Code of Conduct. However, we suggest that it would be appropriate within the guidance for such provisions to include a materiality standard. We also believe that CESR should acknowledge that responsibility for determining whether the available information is sufficient should lie with the credit rating agency.

Fifth, we note that paragraph 16(n) refers to policies with respect to changes in methodologies that “...potentially allow a period for public comment to the CRA, prior to implementing these changes”. Fitch does typically publish Exposure Drafts in order to gather comments from interested parties on significant changes to its methodologies and criteria. However, we note that there is nothing in the EU Regulation that requires credit rating agencies to engage in public consultations ahead of all criteria amendments and we do not think it appropriate to introduce such a requirement through this guidance document. Fitch maintains approximately 400 methodology and criteria reports worldwide. It would not be practical to consult users of our research ahead of every change we might make to each of these reports. Many criteria amendments are relatively minor and to publish Exposure Drafts on all changes would potentially obscure more significant changes under consideration. In addition, there may be certain situations where it is not possible for a credit rating agency to engage in an extensive consultation process. Indeed, in the face of unexpected or rapidly changing events, we may need to revise our methodologies at a faster pace than a consultation process would allow.

On a similar topic, we note that the opening paragraph of Section C indicates that a credit rating agency should demonstrate that its methodologies are “...amended or removed in a way that minimizes disruption”. It is Fitch’s current practice to operate in a responsible and appropriate manner, which avoids unnecessary volatility. At the same time, we would hope that the expectation that credit rating agencies “minimise disruption” is not intended to inhibit a credit rating agency’s ability to comply with the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies, which states that a credit rating agency should “...not forebear or refrain from taking a rating action based on the potential effect...”. We also suggest that the wording in paragraph 19(a) be amended slightly to clarify that credit rating agencies should be expected to demonstrate that their rating methodologies remain globally consistent **to the extent appropriate**, and that paragraph 19(b) be amended to specify that rating methodologies should be updated **as necessary** rather than frequently.

Finally, we note that paragraph 18(b) proposes that credit rating agencies provide to the competent authorities a “summary, by geographical area, of the major differences in the core methodologies”. We respectfully suggest that requirements for summaries of this nature are unreasonably burdensome. As noted earlier, Fitch currently has around 400 criteria and methodology reports. These are freely available on our public website. Among these reports are our Master Criteria, which provide Fitch’s over-arching approach within each asset class. We would hope that providing CESR with our existing Master Criteria reports would be sufficient for this purpose. It would be unnecessarily burdensome to ask our analysts to produce summaries of all of our criteria reports. In addition, it would not seem appropriate simply to review a summary. All of our criteria and methodology reports are designed to be reviewed in their entirety to ensure that the reader has a clear understanding of Fitch’s analytical approach. Paragraph

16(e) also makes reference to credit rating agencies providing “a high level description” of various inputs. Again, we believe these issues are already addressed within our published commentaries and reports, and to require additional summaries is unnecessary.

I hope you find our comments constructive, and that you will give them due consideration. Please do not hesitate to contact me on +44 20 7417 6341, sharon.raj@fitchratings.com or my colleague Susan Launi, Senior European Counsel, on +44 20 7682 7470, susan.launi@fitchratings.com should you wish to discuss this matter further.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'S. Raj', with a stylized flourish at the end.

Sharon Raj
Regional Compliance Officer – Europe, Middle East, Africa and Asia
Fitch Ratings