

CONSULTATION ON GUIDANCE ON THE ENFORCEMENT PRACTICES AND ACTIVITIES TO BE CONDUCTED UNDER ARTICLE 21.3(A) OF THE REGULATION

COMMENTS FROM STANDARD & POOR'S RATINGS SERVICES

1. Introduction

1.1 Standard & Poor's Ratings Services ("*S&P Ratings Services*") appreciates the opportunity to comment on CESR's Draft "*Guidance on the enforcement practices and activities to be conducted under article 21.3(a) of the Regulation*" ("*the Draft Guidance*"). In broad terms, we have two concerns over the Draft Guidance which we ask to be taken into account:-

- (a) Although the Draft Guidance is expressed to be about "*enforcement*" of the EU Regulation, it focuses instead on the information requirements that will be imposed by supervisors on CRAs. The requirements in this Draft Guidance would, if adopted, prove to be very onerous. We have concerns about both the volume of data that CRAs would be required to provide, as well as the frequency with which they would have to do so. Rather than setting strict frequencies, CESR may require "periodic" meetings – to be determined on a case-by-case basis.
- (b) In seeking to set standards for the information that supervisors should request from CRAs, the Draft Guidance does not pay enough attention to the need to ensure that information requests are co-ordinated by the different regulators, so that duplication can be avoided.

2. Information requirements

2.1 We note that paragraph 11 of the Draft Guidance states that "*enforcement does not only cover investigatory activities but also any practices and activities that supervisors may undertake to monitor CRAs on an ongoing basis*". Whilst this may be correct, the Draft Guidance does not in fact focus on the activities that supervisors will undertake, but instead seeks to impose a template for the provision of periodic information by the CRAs to their supervisors. We therefore question whether the content of the Draft Guidance is something that properly falls within the scope of Article 21(3)(a).

2.2 Furthermore, the information set out in the Appendix is very extensive and not in any way called for nor explicitly related to the EU Regulation. If adopted, it would impose an obligation upon CRAs to provide detailed information covering monthly operational data on ratings actions, reviews of ratings methodologies, financial performance (broken down by reference to each type of credit rating), staff turnover and promotion, reviews on ratings models/processes and changes in the location of

lead analysts/outsourcing arrangements. In addition, there would be separate monthly or quarterly requirements to file compliance data.

- 2.3 We firmly believe that it would be disproportionate to require CRAs to file all of this data with the frequency envisaged in the Appendix. In particular, we are concerned that the burden of a monthly reporting cycle could distract compliance personnel from their ongoing monitoring and other duties. It also appears to us that the Appendix would have the effect of imposing obligations upon CRAs that are not imposed by the EU Regulation itself. For example, the Regulation does not require CRAs to conduct reviews of ratings and methodologies nor internal reviews on rating models and rating process on a monthly basis, yet it is implicit from the requirements of the Appendix that such reviews should be conducted.
- 2.4 It appears that CESR's proposals on the content of the Appendix are dictated by the assumption (referred to in paragraph 6 of the Draft Guidance) that a CRA "*is responsible for demonstrating compliance with the requirements of the Regulation on an ongoing basis*". This assumption is not supported by the EU Regulation, which instead requires CRAs to comply with the requirements of the EU Regulation, and competent authorities to supervise that compliance. Clearly, if a supervisor were to query a particular aspect of a CRA's compliance then that CRA should be in a position to demonstrate that it is in compliance. It does not, however, follow from this that CRAs should be expected to demonstrate all aspects of their compliance through routine monthly filings.
- 2.5 We also question whether supervisors would be able to make effective use of such a large volume and frequency of information filings. For example, it is not clear what supervisors would be expected to do with monthly information on financial revenues and costs.
- 2.6 If CESR were to maintain this current approach of setting out a "*typical set of information*" then we believe that it should also explain what it would expect competent authorities to do with that information. We also suggest that each of those supervisory activities should be linked to one of the outcomes or requirements stipulated by the EU Regulation. Such an approach might support a suggestion that the Draft Guidance fell within the scope of Article 21(3)(a), in that its guidance would then be focusing on the activities of supervisors and not the obligations of CRAs to provide information. Furthermore, it would only be possible for CESR to assess the proportionality of the proposed burden on CRAs once there is a clearer understanding of the benefits that the supervisors might achieve through analysing the different categories of information.

3. **Supervisory meetings**

- 3.1 In terms of meetings with supervisors, we welcome the proposal (in paragraph 26) to have a schedule of "*supervisory interaction*" meetings set out in advance. We would, however, question the number and frequency of meetings required in the Draft Guidance. In this respect the Draft Guidance risks being excessively prescriptive and burdensome - for both CRAs and supervisors.
- 3.2 The draft Guidance provides, for example, for supervisors to have monthly supervisory meetings with the compliance officer and quarterly meetings with senior management (as well as for all board minutes to be filed with the supervisor). It is unclear as to what CESR believes such a frequent pattern of meetings would achieve (beyond the limited examples of objectives in paragraph 23 of the Consultation Paper). We believe that, in particular, a pattern of monthly meetings with the compliance officer would be excessive, bearing in mind that it will be necessary for both the CRAs and the supervisors to spend time preparing for each meeting in order to ensure that they are valuable. We do, of course, recognise that there may be circumstances in which monthly (or even more frequent) meetings are appropriate in order to address particular issues or concerns. In such circumstances the supervisors (or indeed the CRAs themselves) can call for such meetings, but we do not believe that CESR should set monthly meetings as the standard pattern. Similarly, we believe that supervisors should be able to take a flexible approach in relation to meetings with the other categories of CRA personnel who are referred to in the Appendix, but which are not involved in credit rating activities. Of those listed, we question the relevance of regular meetings with a Head of Technology/IT.
- 3.3 We also note that paragraph 6 of the Consultation Paper states that competent authorities may conduct onsite inspections or investigations "*themselves or through third parties (like audit companies)*". This language does not appear to be supported by any provision within the EU Regulation, which says (in Article 23) that competent authorities must exercise their powers "*in conformity with national law*". The extent to which the competent authorities can delegate their supervisory activities to third parties is a matter that is governed by national law and not something that can be dictated by CESR's guidance.

4. **The co-ordination of supervisory activity**

- 4.1 The Consultation Paper states, at paragraph 30, that CESR will ensure consistency of approach across colleges and CRAs. It does not, however, state that any measures will be taken to ensure that, within colleges, measures will be taken to avoid the duplication of supervisory action (and the corresponding burden to CRAs in interacting with different supervisors), except that there is a loose reference to a "*work plan agreed by the College*" in paragraph 22. The Draft Guidance should do

more to reflect Recital 58 of the EU Regulation, which states that the use of supervisory measures "*should always be coordinated within the relevant college*".

- 4.2 In particular, the Draft Guidance focuses heavily on the interaction between each individual CRA and its home competent authority. There appears to have been no consideration as to whether some of this interaction could take place at group level, with appropriate co-ordination by the different members of the college. We appreciate that it may be difficult for CESR to be prescriptive as to exactly how such interaction should operate, but we believe that it would at least be helpful if CESR's guidance confirmed, in principle, the desirability of co-operation between the different supervisors when taking supervisory action. This would in particular seem to be appropriate when the supervisors wish to examine the adequacy of any functions (which may include, for example, IT support) that might be organised at group level.