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Committee of European Securities Regulators

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Dear M Demarigny

Response to Call for Evidence on Credit Rating Agencies

Standard & Poor's Ratings Services ("Ratings Services")¹ welcomes this opportunity to respond to the call by the Committee of European Securities Regulators ("CESR") for evidence on possible measures concerning credit rating agencies.²

The European Commission's call to CESR to provide technical advice on these possible measures follows the commitment made by the European Commission at the informal meeting of the EU Council of economic and financial ministers (ECOFIN) in Oviedo, Spain in April 2002 and the resolution of the European Parliament in February 2004 calling on the European Commission to submit its assessment of the need for appropriate legislative proposals (the "European Parliament's Resolution").³ In its call to CESR, the European Commission identifies the following specific issues on which it requires technical advice from CESR:

the interests and conflicts of interest of credit rating agencies;

the fair presentation of credit ratings;

the relationship between issuers and rating agencies and, in particular, the access to inside information by credit rating agencies;

the possible entry barriers to the market for the provision of credit ratings;

the use of ratings in European legislation and in private contracts;

- whether rating agencies should be registered in the EU.

¹ More information about Ratings Services is available at www.standardandpoors.com.

² CESR/04-394, 28 July 2004, available at www.cesr-eu.org.

³ European Parliament resolution on Role and methods of rating agencies (2003/2081(INI)), Tuesday 10 February 2004 (P5_TA(2004)0080), available at www.europarl.eu.int.

In this letter we provide background on the use by market participants of credit rating opinions and discuss some fundamental considerations in relation to the application of regulation in this area. We then discuss each of the key issues raised by the European Commission in turn.

Executive summary

Ratings Services believes that credit rating opinions have served international securities markets extremely well, providing an effective, independent and objective tool in the market's evaluation and assessment of credit risk. Ratings Services believes that the availability of credible credit rating opinions has been a significant factor assisting the development of deeper, broader and more efficient and cost effective international debt securities markets.

Credit ratings are opinions, as of specific dates, of the creditworthiness of a particular company, security, or obligation. There is no one true ratings methodology, and no provably correct rating opinion. Accordingly, different rating agencies are likely to have differing rating opinions, and issuers and market participants will, and often do, disagree with a particular rating opinion. A credit rating is not investment advice. It is not a recommendation to anyone to purchase, sell or hold a particular security; nor does it comment on the suitability of an investment for a particular investor or group of investors.

Recent corporate failures have demonstrated the consequences for all market participants when companies fail to meet their disclosure obligations, or worse -- set out systematically to defraud the market. Like other participants in the marketplace, Ratings Services was similarly misled by the issuers' disclosure failures. However, these events relate to a relatively small number of issuers, as compared with the many thousands of issuers which have been rated, and subject to ratings surveillance, over many decades. They do not indicate that there has been, in fact, any erosion in the independence, objectivity and integrity that have been the hallmarks of the principal international rating agencies.

Ratings Services recognises that the more widespread use of credit ratings in the market and the increased reference to them in regulatory and contractual provisions raises a number of issues. However, Ratings Services believes that the primary response to these issues should not take the form of detailed regulation. Instead, Ratings Services believes that the best regulatory approach is one based on rating agencies themselves taking steps to ensure transparency - to the market, issuers and regulators - as to their methodologies and policies with this non-legislative approach being underpinned by market forces and by the enhanced role given to regulators to recognise rating agencies for the purposes of the proposed Capital Requirements Directive ("CRD") and the Basel II framework. In addition, regulators should strive to ensure the greatest possible consistency of approach, both within the EU and internationally, building on the work of the International Organisation of Securities Commissions ("IOSCO").

2. Market Participants' Use of Credit Rating Opinions

Since beginning its credit rating activities in 1916, Ratings Services has issued rating opinions on more than two million securities issues, corporate and governmental and public finance issuers and structured financings. Ratings Services began its ratings activities with the issuance of credit rating opinions on corporate and governmental debt issues. Responding to market developments and needs, Ratings Services also assesses the credit quality of, and assigns credit

ratings to, financial guarantees, bank loans, private placements, mortgage- and asset-backed securities and the ability of insurance companies to pay claims.

Today, Ratings Services has credit rating opinions outstanding on approximately 150,000 securities issues of obligors in more than 100 countries. Ratings Services issues credit rating opinions and monitors developments pertaining to these securities and obligors from operations in 19 countries around the world.

Ratings Services has been present in Europe for more than 20 years, currently employing 600 staff, including 300 credit analysts, in offices in Frankfurt, London, Madrid, Milan, Moscow, Paris and Stockholm. The staff in these offices play a crucial role throughout the rating process for European issuers, leading the initial credit analysis, in rating committees and in ongoing surveillance.

Ratings Services' credit rating opinions have achieved worldwide market recognition and acceptance - not only with issuers and investors, but also with bankers, financial intermediaries and securities traders - as efficient tools for differentiating credit quality. Underlying the credibility of Ratings Services' rating opinions is the market's recognition of the independence, integrity and objectivity of Ratings Services and the quality of its credit rating opinions.

On a daily basis, Ratings Services issues between 500 and 1,000 rating actions around the globe. These rating actions include initial ratings, rating changes, CreditWatch listings (which are used to signal to investors that further analysis is being performed and that a rating might be changed as a result of a specific event), Outlook changes (which represent Ratings Services' opinion as to the future direction of the rating, covering a six-month to two-year time horizon) and rating affirmations. It is through this daily process that Ratings Services' credit rating opinions are subject to constant market scrutiny. Ratings Services' focus is on furnishing rating opinions that will prove to be as credible and relevant as possible.

Over almost a century, Ratings Services' mission has remained the same - to provide high-quality, objective, rigorous analytical information to the marketplace. The track record of Ratings Services' credit rating opinions continues to be excellent, as demonstrated by studies on rating trends and default and transition studies regularly published by Ratings Services. These studies have repeatedly shown that there is a clear correlation between ratings assigned by Ratings Services and the likelihood of default: the higher the rating, the lower the probability of default, and vice versa.

Nevertheless, credit ratings are opinions, as of specific dates, of the creditworthiness of a particular company, security or obligation. There is no one true ratings methodology, and no provably correct rating opinion. Accordingly, different rating agencies are likely to have differing rating opinions, and issuers and market participants will, and often do, disagree with a particular rating opinion. A credit rating is not investment advice. It is not a recommendation to anyone to purchase, sell or hold a particular security; nor does it comment on the suitability of an investment for a particular investor or group of investors.

Recent corporate failures have demonstrated the consequences for all market participants when companies fail to meet their disclosure obligations, or worse - set out systematically to defraud the market. Like other participants in the marketplace, Ratings Services was similarly misled by the issuers' disclosure failures. However, these events relate to a relatively small number of

issuers, as compared with the many thousands of issuers that have been rated, and subject to ratings surveillance, over many decades. They do not indicate that there has been, in fact, any erosion in the independence, objectivity and integrity that have been the hallmarks of the principal international rating agencies. While there will be occasions when Ratings Services' ratings are scrutinised with the benefit of hindsight, including as a result of unforeseeable or simply unknowable events, Ratings Services' excellent track record demonstrates why its credit rating opinions are widely accepted as credible by the major users of credit rating opinions around the world.

3. Fundamental Considerations

Ratings Services recognises that the more widespread use of credit ratings in the market and the increased reference to them in regulatory and contractual provisions raises a number of issues. However, Ratings Services believes that the primary response to these issues should not take the form of detailed regulation. Instead, Ratings Services believes that the best regulatory approach is one based on rating agencies themselves taking steps to ensure transparency - to the market, issuers and regulators - as to their methodologies and policies with this non-legislative approach being underpinned by market forces and by the enhanced role given to regulators to recognise rating agencies for the purposes of the proposed CRD and the Basel II framework. In addition, regulators should strive to ensure the greatest possible consistency of approach, both within the EU and internationally, building on the work of IOSCO and, in particular, IOSCO's Statement of Principles Regarding the Activities of Credit Rating Agencies (the "IOSCO Principles").⁴

Ratings Services believes that regulation should not attempt to influence, directly or indirectly, the methodologies and processes used by rating agencies to arrive at their rating opinions. In particular, regulation should not attempt to prescribe methodologies or processes. Any such attempt is likely to be unsuccessful and counterproductive; it risks raising barriers to entry in the market, compromising the independence of rating agencies, stifling innovation and undermining the value to users of ratings opinions.

Instead, Ratings Services believes that the onus should be on rating agencies themselves to develop their own policies and make them available to the market, regulators and the general public. IOSCO is already working on a draft model of a code of conduct, following on from its work on the IOSCO Principles. While the details of any such code will be the subject of discussion, Rating Services supports the general approach of having rating agencies determine their own codes in the light of principles set by IOSCO instead of detailed regulation. Ratings Services strongly believes that a rating agency's own code should make clear that it has policies designed to ensure, among other things:

- the independence of the rating process, both from external and internal, business-related influences;
- clear communication with issuers about the rating process and rating opinions, including an opportunity for issuers to object to rating opinions, where this is possible without interfering with the prompt communication to the market of rating opinions;
- significant disclosure to the market of rating procedures and methodologies;

⁴ Statement of the Technical Committee, 25 September 2003, available at www.iosco.org

appropriate behaviour by individual staff members at rating agencies, in particular preventing market abuse and conflicts of interest.

However, Ratings Services does not believe that it will be necessary for there to be new legislative or regulatory initiatives (either at the EU or national level) to underpin this approach.

First, market forces will themselves play an important role in ensuring that rating agencies live up to their published standards. A rating agency's failure to comply with those standards will undermine the credibility of its ratings opinions and its market position. As two Federal Reserve Board economists recently concluded after intensive study and analysis, Rating Services and the other rating agencies consider their reputations in the marketplace to be of "paramount importance" and, in fact, are "motivated primarily by reputation-related incentives."⁵

Secondly, Rating Services believes that the process for recognising rating agencies already embedded in the proposed CRD and the Basel II framework should, if properly structured and implemented, be capable of providing regulators with an appropriate opportunity to consider ratings agencies' actual practices against their own published standards. The Basel II criteria for recognition already include requirements as to the independence, objectivity, transparency, disclosure, resources and credibility of ratings agencies. There is no need to amend these to include new requirements. It is unlikely that a rating agency that manifestly failed to comply with its own published policies would be able to meet these requirements.

Ratings Services believes that this approach has a number of advantages:

- It should be relatively quick and simple to implement.

It avoids some of the practical issues that would accompany any new legislative or regulatory initiative. For example, any new legislation or regulations would need to be able to define credit rating agencies in a satisfactory way and to decide whose rules apply in a cross-border context - both of which are not without difficulty.

It is less likely to give rise to unexpected or disproportionate implementation costs or unintended adverse consequences for the market or market participants. In particular, it avoids intrusive oversight or regulation of rating agencies that might appear to provide government or regulatory endorsement for individual rating opinions.

It is likely to present fewer barriers to entry to new entrants, particularly those that might have different business models.

- It is likely to raise fewer issues as to the compatibility of the approach with the fundamental freedoms of expression guaranteed by the European Convention on Human Rights.

It is also more flexible, as it is not tied to a particular legislative framework that might, over time, prove unsuitable and difficult to change. In addition, because regulators would be reviewing rating agencies against their own standards, it would reduce the risk of

See Daniel M. Covitz and Paul Harrison, Testing Conflicts of Interest at Bond Ratings Agencies with Market Anticipation: Evidence that Reputation Incentives Dominate, The Federal Reserve Board Finance and Economics Discussion Series (December 2003), at 1, 3, available at www.federalreserve.gov/pubs/feds/2003/200368/200368pap.pdf

homogenisation of ratings or the behaviour of ratings agencies, through government mandated minimum or uniform requirements which might stifle innovation and creativity.

Furthermore, this approach accords with the recommendations made in the recent draft reports to the European Commission of the four independent groups of experts convened to consider the state of financial integration in the banking, insurance, securities and asset management sectors.⁶ Among other things, these reports advocated that non-legislative solutions should be considered ahead of regulation and argued that new legislative measures should only be brought forward when impact assessments make a convincing case that the expected benefits to industry will outweigh adjustment or compliance costs. Ratings Services believes that no such case has yet been made for new legislative or regulatory initiatives in this area.

Finally, Ratings Services believes that this approach is the most likely to achieve consistency of approach with other international regulators. It builds on the work of IOSCO in this area. It would establish an appropriate parallel with the approach currently taken by the US Securities and Exchange Commission, which also rests on the recognition of rating agencies for regulatory capital purposes - as nationally recognized statistical rating organizations ("NRSROs"). However, if properly structured and implemented, it should not present significant new barriers to entry.

That is not to say that the approach is without difficulty. As highlighted below, Ratings Services is concerned by aspects of the CRD/Basel II framework and the prospect of duplicative and disproportionately burdensome requests for information, especially given the possibility of rating agencies having, in effect, to seek recognition in all 25 member states. However, Ratings Services believes that CESR and the Committee of European Banking Supervisors have important roles to play in co-ordinating the process.

4. Technical Advice relating to the Issue of Interests and Conflicts of Interest for Credit Rating Agencies

In section 3.1 of its call to CESR for technical advice, the European Commission seeks advice on the interests and conflicts of interests of rating agencies and its views on the optimal regulatory ways to deal with them, specifically considering the following issues:

The provision of advisory/ancillary services by credit rating agencies, including in particular the possible need for rating agencies to disclose, manage or prohibit the provision of advisory services to issuers;

The possible need for rating agencies to disclose the existence (but not the amount) of, or manage, payments by issuers for credit rating opinions;

The possible need for rating agencies to disclose, or manage, unsolicited ratings;

The possible need for rating agencies to disclose the existence of capital links or any other interest links between rated issuers and rating agencies.

We consider each of these in turn.

⁶ These reports are available at http://europa.eu.int/comm/internal_market/en/finances/actionplan/stocktaking.htm.

(a) *Technical advice relating to provision of advisory/ancillary services by credit rating agencies*

Throughout its history, Ratings Services has dedicated itself to the principles of independence and objectivity. These principles have become Ratings Services' hallmarks and contribute greatly to the value of Ratings Services' rating opinions in the marketplace.

Ratings Services does not believe that there should be any substantial concerns about ancillary business activities. To Ratings Services' knowledge, there have been no findings of conflicts or abuse in the credit rating industry in general or specifically with respect to rating agencies' ancillary business activities. Any attempt to prohibit the carrying on of ancillary business activities would be an overreaction.

There are many activities which pose no threat to the independence and objectivity of the analytical process and which might be described as "ancillary". Firewalls and other appropriate measures for safeguarding against conflicts of interest have worked well in the past and, in Ratings Services view, can and should provide an important check on potential problems.

Any proposal to prohibit ancillary business activities may also have unintended and unwarranted reach. Ratings Services is part of Standard & Poor's which itself is a division of The McGraw Hill Companies, Inc. The McGraw Hill Companies and Standard & Poor's provide numerous products and services to customers all across the globe. While some of the customers of The McGraw Hill Companies and Standard & Poor's are also issuers about whom Ratings Services issues ratings, those business units are separated from Ratings Services' activities and have absolutely no involvement in the ratings process. For example, firewalls and other appropriate measures are used to separate Ratings Services from the index, equity research, risk solutions, corporate value, funds and data services businesses of Standard & Poor's.

For these reasons, Ratings Services believes that the appropriate way to address any concerns that there may be regarding ancillary business activities is for rating agencies to have policies for the separation of their ratings businesses from other businesses that may present a conflict of interest. In contrast to the position concerning equity research, where regulators have had specific concerns about the relationship with the firm's investment banking activities, it is difficult to identify any relationships that should be the subject of specific disclosures, while additional general disclosures are unlikely to be of real value to users of rating opinions.

(b) *Payments by issuers for credit rating opinions*

As regards the payment for credit ratings to credit rating agencies by rated issuers, Ratings Services currently discloses a range of fees received for each rating opinion it disseminates, in line with the IOSCO Principles regarding such disclosure.⁷ Ratings Services believes that this practice provides the market with valuable information and allows the market to evaluate effectively the fees received by Ratings Services from issuers. Furthermore, Ratings Services rates such a large number of issuers that no one issuer is responsible for more than a very small portion of Rating Services' revenue, certainly not enough to threaten Ratings Services' analytical independence.

⁷ Paragraph 2.6 of the IOSCO Principles.

In addition, Ratings Services has other long-standing policies and procedures designed to ensure that the credit rating opinion on an issuer is not affected by the existence of or potential for a business relationship between it and the issuer.⁸ In particular, it has policies preventing analysts from participating in commercial discussions with issuers on fees. In addition, Ratings Services does not compensate or evaluate analysts based on the amount of revenues that Ratings Services derives from issuers that the analyst rates or with which the analyst regularly interacts.⁹

Ratings Services believes that these procedures and practices adequately address the issues arising from issuers' payments for ratings. It does not believe that the marketplace would benefit additionally from more precise disclosures that might impose a significant burden on rating agencies.

(c) Possible need for rating agencies to disclose, or manage, unsolicited ratings

Ratings Services does issue credit rating opinions without the full participation of issuers in the rating process if it believes that there is a meaningful credit market or investor interest served by the publication of such a rating and it has sufficient information to support adequate analysis and, if applicable, ongoing surveillance. In line with the IOSCO Principles,¹⁰ Ratings Services' credit rating opinions disclose when ratings are not initiated at the request of the issuer and whether the issuer has participated in the rating process.

(d) Possible disclosure of capital or other links with issuers

Issues regarding capital links with rated issuers are not, in practice, significant for Ratings Services. While Ratings Services is a part of Standard & Poor's which itself is a division of The McGraw Hill Companies, Inc., Ratings Services' business is separated from other businesses as described above.

5. Technical Advice related to the Fair Presentation of Credit Ratings

In section 3.2 of its call to CESR for technical advice, the European Commission seeks advice on whether regulatory measures are required to address the fair presentation of credit ratings, including possible requirements to disclose or regulate the skills of rating agencies' staff and their rating methodologies.

(a) Regulation of fair presentation of credit ratings opinions

As is recognised in the European Commission's call to CESR and the European Parliament's Resolution, ratings opinions are different from investment recommendations. It would be inappropriate to seek to apply the same regulatory techniques to the regulation of rating agencies as is applied to investment recommendations. Taking just one example, requirements to disclose the identity of the individual responsible for the production of ratings would be inappropriate, in as much as rating opinions are assigned by a committee process rather than by individuals.

(b) Disclosure of ratings procedures and methodologies

⁸ Paragraph 2.2 of the IOSCO Principles. See below regarding the separation of other businesses.

⁹ Paragraph 2.4 of the IOSCO Principles.

¹⁰ Paragraph 3.5 of the IOSCO Principles.

It is already Ratings Services' established policy, in line with the IOSCO Principles,¹¹ to publish extensive information about its procedures and methodologies so that outside parties can understand how Ratings Services arrives at a rating opinion. This includes information on the meaning of each rating category, the definition of default and the time horizon used when making a rating decision. Ratings Services also publishes extensive information on the criteria for rating particular types of issuers and transactions¹² and it discloses the rationale for individual rating opinions in the accompanying releases. In addition, it publishes studies of historical default rates of rating categories so that interested parties can understand the historical performance of each category.¹³ These disclosures enhance the value of Ratings Services' rating opinions in the marketplace by demonstrating the credibility of the process applied and are a necessary underpinning enabling the establishment of ratings as a common benchmark.

(c) *Imposing regulatory criteria as to ratings methodologies and processes*

Imposing regulatory criteria as to rating methodologies or processes or other operational, policy or rating requirements (such as criteria relating to the number or training of analysts) is unlikely to be helpful and could well be counter-productive. Such criteria cannot assure credible rating opinions and they risk erecting barriers to entry. They could have the unintended consequence of compromising the independence of a rating agency's analysis and could risk setting minimum or uniform standards of credit analysis. This could erode the individual quality and independence of the rating agency's credit analysis, could stifle innovation in credit rating analytic technologies and may limit the availability of valuable credit analysis and information in the marketplace, to the detriment of investors and the transparency of the securities market. In such event, credit ratings no longer would represent the particularized opinion of the credit rating agency based on the rating agency's independent assessments.

Ratings methodologies, processes and policies are intertwined with the substance of the ratings opinion itself. The European Parliament's Resolution itself decisively rejected any attempts at regulatory intervention into the substance of ratings opinions or in the timing of publication of those opinions and stressed the need for total freedom of expression and for rating agencies' independence from political and business influence.¹⁴

We discuss our comments on the proposed recognition criteria in the proposed Capital Requirements Directive below.

6. **Technical Advice concerning the Relationship between Issuers and Rating Agencies**

(a) *Technical advice relating to the access to inside information by credit rating agencies*

In section 3.3.1 of its call to CESR for technical advice, the European Commission requests CESR to provide advice on whether measures are required to address access to inside information by credit rating agencies.

¹¹ Paragraph 3.3 of the IOSCO Principles.

¹² For more information, see Credit Ratings Criteria under Credit Ratings at www.standardandpoors.com.

¹³ See paragraph 3.4 of the IOSCO Principles.

¹⁴ Paragraph 11 of the European Parliament's Resolution.

Ratings Services believes that the EU's new Market Abuse Directive¹⁵ represents a significant step forward in clarifying the respective rights and obligations of issuers and third parties with respect to the handling of inside information and already adequately addresses the principal issues relating to the access to inside information by credit rating agencies.

The Market Abuse Directive allows an issuer to delay the public disclosure of price sensitive information where disclosure would prejudice the issuer's legitimate interests, provided that the issuer is able to ensure the confidentiality of the information (article 6(2)). The Directive also allows an issuer to disclose such information privately to a third party, such as a rating agency, where the recipient is under a duty of confidentiality, regardless of whether such duty is based on a law, on regulations, on articles of association or on a contract (article 6(3)).

Ratings Services believes that it is essential that a rating agency can receive complete and accurate information as part of the credit rating process. It is helpful that the Directive makes clear that issuers can have an open dialogue with rating agencies, including disclosing non-public price-sensitive information on a confidential basis.

It is also essential that the rating agency is able to use that information in its evaluation of the issuer's credit and is able to publish the results of that evaluation in the form of a rating opinion or a change to a rating opinion (so long as it does not disclose the information itself). Ratings Services' paramount duty to maintain a fair and objective rating may sometimes require it to take rating action based on information that it cannot disclose for reasons of confidentiality.¹⁶

The Directive does not prohibit the use of non-public information as the basis of publication of a rating action in this way. Credit ratings are not recommendations (or inducements) of the kind described in article 3(b) of the Directive, which prohibits a person recommending or inducing another person, on the basis of inside information, to acquire or dispose of financial instruments. As is recognised by, among other things, the measures implementing the Directive itself,¹⁷ credit ratings are quite distinct from investment recommendations; a credit rating opinion is not a recommendation to buy, sell or hold any financial instrument. A credit rating is an expression of opinion as to the relative creditworthiness of a particular instrument or issuer. A rating opinion does not indicate any view as to whether it is desirable to buy, sell or hold any financial instrument or any particular investment strategy. Nor is it possible to draw any conclusion as to an investment strategy from a credit rating opinion alone. Ratings opinions do not comment on whether the rated security is suitable for any individual investor. Similarly, ratings opinions do not comment on the price or market value of any security.

¹⁵ Directive 2003/6/EC of the European Parliament and the Council on insider dealing and market manipulation (market abuse).

¹⁶ The traditional method for dealing with this is to explain the rating action in general terms. For example, a company may disclose that a particular large bank facility is coming up for renewal and that it had not, so far, been able to line up any alternative lenders. This could lead to a downgrade in the company's rating. However, the refinancing problem that leads to that rating action is confidential. The downgrade in rating would therefore be justified by reference to "concerns regarding liquidity".

¹⁷ See recital 10 of the Commission Directive 2003/125/EC implementing Directive 2003/6/EC of the European Parliament and the Council as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest.

It would largely undermine the value of disclosure – making it potentially irrelevant – if a rating agency were unable to use disclosed information in its evaluation of the issuer's credit. Furthermore, if rating agencies were prohibited from issuing ratings opinions which make use of non-public price sensitive information legitimately provided to them by European listed companies, and were unable to disseminate ratings opinions, or changes to ratings opinions, on a timely basis (if at all) based on this information even if they comply with their duty of confidentiality as to non-public information, this would be likely to lead to issuers and rating agencies restricting the flow of information between them. This is likely to have an adverse effect on the quality of information provided to investors in the securities of European issuers. This would undermine the competitiveness of European markets and damage Europe's position as the home for the international debt securities markets.

The Directive also provides an adequate framework of sanctions against misuse of inside information. In particular, the Directive clearly requires all member states to impose appropriate sanctions should an employee of a rating agency (or, indeed, the agency itself) seek to misuse inside information by dealing in relevant financial instruments, using the information to recommend or induce others so to deal or disclosing the information to third parties in breach of the rating agency's duties of confidentiality (articles 2 and 3). In line with the IOSCO Principles,¹⁸ Ratings Services has long-established policies prohibiting dealings in securities by staff (and members of their immediate family), which include provisions prohibiting dealings where the member of staff has received confidential information concerning the issuer.

(b) *Technical Advice concerning other Issues related to the Relationship between Issuers and Rating Agencies*

In section 3.3.2 of its call to CESR for technical advice, the European Commission asks CESR to consider a number of other issues regarding the ability of issuers to discuss ratings with credit rating agencies, the role of issuers in ensuring the accuracy of information published by rating agencies and record keeping.

Ratings Services believes that these issues are already adequately addressed by its established internal policies and procedures. These already require issuers to be kept informed of the ratings process and provide an appeal process for issuers against a rating decision, where circumstances allow, based on material new information or significant clarification or interpretation of existing information. They also allow the issuer to be given prior notice of the contents of a rating press release so that the issuer can correct factual errors or prevent the inadvertent release of confidential information. In addition, they include policies and procedures for keeping appropriate records with respect to the rating decision.

In this regard, Ratings Services would note its concerns about any proposals that would, in effect, create a framework for mandatory arbitration about the validity of a particular rating opinion. Even if the framework is expressed to be limited to arbitration of some aspects of the process by which a rating opinion is arrived at or publicised, it could be used by an issuer to seek to overturn a particular rating opinion with which it disagrees by alleging a failure to comply with particular processes.

¹⁸ Paragraph 2.3 of the IOSCO Principles.

Making such a mechanism available to issuers would undermine the market's ability to use credit ratings opinions, as it would undermine the assurance that the rating represents the current opinion of the rating agency and the market would have difficulty evaluating credit ratings opinions which have been the subject of arbitration, in the absence of a consistent track record of arbitrators. Such a framework would undermine the independence of rating agencies and create conflicts of interest; issuers would tend to challenge rating opinions when they are lower than desired and the threat of such a challenge may provide rating agencies with an incentive to issue higher ratings to avoid arbitration. It is also unclear how, in practice, an arbitrator would acquire the experience and industry knowledge to determine whether the application of particular criteria and/or methodologies was appropriate. Ratings Services' policies and procedures already carefully balance the desire to involve the issuer in the process while preserving the independence of the ratings decision and in particular the freedom to ensure that ratings decisions are taken and disclosed promptly where required.

(c) *Advice concerning equal access to information by rating agencies*

In section 3.3.1 and 3.3.2 of its call to CESR for technical advice, the European Commission asks CESR the need to ensure a level playing field between rating agencies and specifically whether there should be further regulation to ensure that all rating agencies have access to the same information from companies (the European Commission's paper also refers to a concept of a rating agency data room).

Ratings Services does not believe that it is necessary to adopt regulations compelling issuers to give the same information to different rating agencies. Credit ratings typically disclose whether or not the issuer has participated in the process, so it will be clear to users that there is a disparity of information between agencies in a case where the issuer participates in the rating process with only one or some of the rating agencies which rate that issuer or its securities. Where the issuer is participating in the rating process with two or more rating agencies, the rating agencies may have different methodologies with differing information requirements which may justify the provision of differing information. If there is any disparity in ratings between agencies, which cannot be explained by differences in methodology, this is likely to lead to an agency making follow up enquiries. Rating Services reserves the right to withdraw its ratings if it considers that there has been inadequate disclosure.

On the other hand, regulation plays an important role in ensuring that issuers provide adequate transparency to the market generally. Ratings Services believes that the enhanced continuous disclosure obligations in the Market Abuse Directive, the implementation of International Financial Reporting Standards in the EU and the forthcoming requirements of the Prospectus and Transparency Obligations Directives should assist, overall, in providing more and better quality information to the market. The effective implementation of these measures should assist in equalising the position of investors and, indirectly, assisting in the rating process.

7. *Technical Advice related to Possible Entry Barriers to the Market for the Provision of Credit Ratings*

In section 3.4 of its call to CESR for technical advice, the European Commission asks CESR for advice on whether there are any entry barriers to the market for credit ratings arising from regulatory requirements as regards the new framework for capital requirements for banks and investment firms.

At present, Ratings Services does not believe that the current, relatively limited use by regulators and legislators in Europe of credit ratings presents a significant barrier to entry. However, we do have a number of concerns about the complexity and structure of the recognition criteria in the proposed CRD and the Basel II framework.

We are especially concerned about the sheer volume of information that may be requested under the CRD/Basel II framework. We believe that it will be important that, wherever possible, requests for information do not extend beyond that which is already publicly available or is prepared for use in the process generally and that these requests are consistent across jurisdictions. This will be of particular concern if multiple jurisdictions request differing information on an ongoing basis as part of the surveillance process. These concerns are exacerbated by the fact that the proposed CRD would allow every member state to carry out its own process for determining whether to recognise particular rating agencies, even if they may recognise a determination made by another member state. The more burdensome the process, the more likely it is to adversely affect competition between rating agencies.

8. Technical Advice related to the Use of Ratings in European Legislation and in Private Contracts

In section 3.5 of its call to CESR for technical advice, the European Commission asks CESR for advice on whether there should be further use of ratings in European legislation and as to whether there are any issues relating to the use of ratings in private contracts.

While appropriate legislative and regulatory uses of credit ratings exist, Ratings Services does not seek the wider use of ratings in legislation or regulation. In general, it believes that it is preferable not to use ratings in legislation or regulation where the regulatory objectives can be met by some other technique.

Clearly, the use of ratings in private contracts can give rise to particular issues, for example where a rating downgrade could trigger additional collateral requirements. However, it should be left to the parties to the contract to negotiate appropriate arrangements, taking into account proper principles of risk management. Nevertheless, Ratings Services believes that issuers should disclose the existence of such triggers to rating agencies in the course of the rating process, so that the agency can consider the possible impact on the financial position of the issuer. In addition, in some cases, the nature or extent of the use of such triggers may be material for disclosure for investors, either in prospectuses or, in appropriate cases, ad hoc disclosures.

9. Registration

Finally, in section 3.6 of its call to CESR for technical advice, the European Commission asks CESR to consider whether rating agencies should be registered in the EU. Ratings Services believes that the imposition of a separate registration requirement on rating agencies is unnecessary and would be inappropriate. The recognition process envisaged by the CRD/Basel II framework should, if appropriately structured and implemented, be sufficient to create an appropriate link between significant rating agencies and European regulators. Any requirement for rating agencies to register as such would require separate legislation for little obvious advantage, but with potential serious disadvantages. At the very least, as the European

Commission points out, there is a risk that it could create an impression that a rating is officially endorsed and thus guaranteed.

Ratings Services appreciates the opportunity to address the issues raised in the call for evidence and looks forward to further discussion with CESR on CESR's advice to the European Commission.

Very truly yours,



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