COMPANHIA PORTUGUESA
DE RATING, S.A.

Ref.:

Call for evidence

on the assessment of compliance of credit rating agencies with Article 8.3 of the Credit Rating Agencies Regulation (1060/2009/EC)

On the mentioned Call for evidence Companhia Portuguesa de Rating, S.A. (CPR) wishes to comment on the following (following the numbers of the questions on the text):

1. Please indicate (i) the name of your organization; (ii) your annual revenues (from the most recent annual report); (iii) the nature of your business (e.g. CRA, association, etc); (iv) your areas of specialization (e.g corporates, structured finance, financial institutions, insurance)

For your reference, as asked, Companhia Portuguesa de Rating, S.A. is presently registering as a CRA with ESMA and had annual revenues of 618 961,85 € in 2010, mainly in the area of corporate ratings, with marginal ancillary services.

<u>1. Questions to CRAs – Direct costs and benefits to the CRA</u>

2. Has compliance with Article 8 (3) resulted in changes to your business practice? To the extent possible, please quantify any costs and benefits.

Compliance with Regulation 1060/2009 in general, including Article 8(3), resulted in several changes in CPR's organizational structure, and formalization of internal manuals and codes of conduct, but not that much in the business practice itself.

It had costs to deal with consultation papers, papers, regulations, manuals, CESR/ESMA instructions, CEREP, internal adaptations in organization, methodologies, documents, manuals, codes of conduct, meetings in CESR/ESMA premises in Paris and with local authorities, that we estimate in over 100 000,00 € (huge for its level of revenues).

3. Which of the guidelines within the CESR Guidance are you already implementing on an ongoing basis as part of the registration process?

We included the answer to the Guidance on Article 8(3) (CESR/Ref. 10-945, CESR Guidance) as a chapter of CPR's Registration Process as CRA, sent to CESR in the first days of September 2010, so we think we are already implementing all those guidelines on an ongoing basis.

COMPANHIA PORTUGUESA DE RATING, S.A.

5. Please state whether you consider there are any benefits from the standards embodied in the CESR Guidance for your organisation, for example:

a. **Through reputational improvements resulting from improved accountability of credit rating methodologies;**

b. **Improvements to the process of producing and monitoring rating methodologies;**

c. **Improvements to the quality of credit ratings.**

Please quantify these benefits where possible.

The benefits from the standards embodied in the CESR Guidance, as the ones examplified, are vague, uncertain and very difficult to quantify.

6. Will the standards embodied in the CESR Guidance, if transposed to RTS, result in changes to your business model or operation (e.g changes to rating development and innovation, hampering of new business lines or closure of existing business lines, etc.)? Please provide details and quantify any cost and benefits.

The standards embodied in the CESR Guidance impose very high fixed costs in red tape (producing, proving the existance and approving standards and manuals with ESMA) and, as such, constitute high barriers to competition in the rating sector, both for the creation of new CRAs and for the development of new business lines in the existing smaller CRAs.

2. Questions for all stakeholders

7. What do you consider to be the most important factors within a credit rating methodology to ensure that it is:

a. **rigorous;**

b. **systematic;**

c. **continuous; and**

d. **subject to validation based on historical experience, including back-testing?**

Please provide as much detail as possible, including reasons, and please list each factor by reference to each requirement.

We would like to call your attention to two factors:

i) It is impossible to be rigorous / independent when rating an issuer if a CRA had other revenues from

COMPANHIA PORTUGUESA DE RATING, S.A.

that issuer in (say) the previous five years. (Real) example: how can a CRA be independent in rating a Portuguese bank if it is at the same time receiving from the same bank fees to set up its internal rating system? So it should be absolutely forbiden to rate an issuer or an issue from an issuer from which the CRA received any non-rating revenue in (say) the previous five years (also related to question **8. In relation to each of the factors identified in Q7, is there a factor that is not covered by the standards embodied in the CESR Guidance published on 30 August 2010? If so, please provide reasons as to why that factor should be included in the RTS**).

ii) It is virtually impossible to have statistically valid validation based on historical experience, including back-testing in small markets (as Portugal), and this applies to CPR and to the biggest CRAs. AND IT IS THEORETICALLY WRONG TO ASSUME THAT THE BEHAVIOUR OF PORTUGUESE ISSUERS IS THE SAME AS AN INTERNATIONAL AVERAGE, AS IT HAS BEEN PROVEN IN WELLKNOWN PAPERS IN THIS AREA SINCE ALTMAN. So this issue is even worst for the biggest CRAs in Portugal than for CPR in Portugal, since we have more ratings issued in Portugal than any one of them (also related to the question **10. Do you consider that the requirements of Article 8(3) could be met without implementing any of the standards embodied in the CESR Guidance? If so, do you consider this would result in a greater or lower efficiency for CRAs and/or stakeholders? Please provide details. If there are less burdensome alternatives that would secure equivalent effects, please describe them**).

13. Will the standards embodied in the CESR Guidance, if transposed to RTS, have an impact on market size, market structure and your position in the markets within which you operate? Specifically, do you expect:

a. **Markets to grow, shrink or to remain unaffected? Please specify and explain.**
b. **Your competitive position to be enhanced or weakened? If so, please elaborate.**
c. **The introduction of prohibitive barriers to entry to new CRAs? If so, please elaborate.**
d. **Disproportionate impacts (e.g. market exit) on smaller or local CRAs? If so, please elaborate.**

As explained in answer to question 6, the standards embodied in the CESR Guidance impose very high fixed costs in red tape (producing, proving the existance and approving standards and manuals with ESMA) and, as such, constitute high barriers to competition in the rating sector, both for the creation of new CRA and for the development of new business lines in the existing smaller CRA.

COMPANHIA PORTUGUESA DE RATING, S.A.

14. What costs or benefits do you expect the standards embodied in the CESR Guidance, if transposed to RTS, to have on financial markets or the wider economy, for example, through:

a. **Changes to regulatory capital holdings?**

b. **Effects on the price of raising capital?**

c. **Improvements in mitigating risks to the financial system?**

d. **Using credit ratings of better quality?**

All the cost assotiated with less competition in the rating sector, that are already becoming very visible in the present economic and financial crisis will be exacerbated in the future: regulatory capital holdings based on bad quality ratings, higher price of raising capital as issuers will be dependent on a few oligopolistic CRAs, higher risk to the financial system, as there will be no other CRAs as alternatives, worst quality credit ratings.

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