

European Securities and Markets Authority
103 rue de Grenelle
75007 Paris
France
www.esma.europa.eu

Chris Barnard
Germany

27 September 2011

- Your Ref: Comment letter on Consultation Paper on Regulatory technical standards on the assessment of compliance of credit rating methodologies with the requirements set out in Article 8(3) of Regulation (EC) No 1060/2009

Dear Sir,

Thank you for giving us the opportunity to comment on your Consultation Paper: Regulatory technical standards on the assessment of compliance of credit rating methodologies with the requirements set out in Article 8(3) of Regulation (EC) No 1060/2009.

I agree with your proposed regulatory technical standards (RTS). I would like to add some comments on disclosure, testing and analysis, and internal controls.

Further disclosures, procedures and methodologies

Paragraph (3) of the preamble requires that CRAs: “use credit rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing”. Paragraph (9) of the preamble further requires a CRA that changes its methodology to disclose the likely effects of the change, to review affected credit ratings, and re-rate those affected credit ratings accordingly. I support the intention to provide greater transparency and auditability of credit rating methodologies, procedures and assessments, including allowing longitudinal tracking of the procedure or methodology version used. Should any disclosure thereon also include proprietary or confidential information, either about issuers or the CRA itself?

Sensitivity testing

Proposed Article 6.3(a) requires a sensitivity analysis to be performed in order to validate the credit rating methodology. For completeness, I would recommend that you should propose the following sensitivity analyses, which would be sufficient and complete in this regard:

- 1) the sensitivity of the credit rating methodology to changing individual assumptions (sensitivity analysis as proposed);
- 2) the sensitivity of the credit rating methodology to changing several assumptions at the same time, where the assumptions could reasonably be expected to change together (scenario analysis);
- 3) the dependencies assumed between assumptions.

I do not believe that the additional analyses would be onerous for CRAs. I would argue that having a good understanding of your credit rating operational and risk drivers, including their dependencies, is vital to properly understand and manage a credit rating methodology.

Answers to specific questions raised by ESMA

Questions 1-3: Assessing that a credit rating methodology is rigorous, systematic and continuous.

CRAs should thoroughly document all aspects of their credit rating methodologies, principles, procedures, processes, inputs and other assumption, and all testing and internal controls performed thereon. Any changes or exceptions¹ should be documented, with reasons, and approved by the internal control function. This should be required and necessary as this is part of any comprehensive control concept (CCC) or basic risk management process.

Yours faithfully

C.R.B.

Chris Barnard

¹ For example Article 4.1 states that a credit rating methodology should be applied systematically "unless there is an objective reason for diverging from it". Such reason should be documented and approved.