



Fédération Bancaire Européenne
European Banking Federation
Le Secrétaire Général

COK
No 0562

Mr. Fabrice Demarigny
Secretary General
Committee of European Securities Regulators
11-13 Avenue de Friedland
75008 Paris
France

Brussels, 27 August 2004

Subject: CESR Call for evidence on possible measures concerning credit rating agencies.

Dear Mr Demarigny

Please find attached the FBE's response to the above-mentioned consultation.

Yours sincerely,

Nikolaus BÖMCKE

Enclosure: 1



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24/08/2004

Response to CESR's Call for Evidence on
Credit Rating Agencies ("CRAs")
August 2004

Introductory remarks

1. The FBE welcomes the opportunity to provide input to CESR's initial call for evidence for the development of technical advice on possible measures concerning Credit Rating Agencies (CRAs). We are, however, disappointed to note that CESR has provided market participants with a one month deadline during the holiday period, therefore reducing the possibility for associations to hold a constructive and efficient consultation with their members. Such short deadlines jeopardise the quality of the input to CESR and subsequently the quality of the advice CESR delivers to the Commission.
2. The FBE responded to the European Parliament's Own Initiative Report on Credit Rating Agencies in January 2004. We believe that the key points highlighted in that response should form the basis for any measures on CRAs:
 - Increased disclosure obligations on CRAs would contribute to greater transparency in European capital markets;
 - Legislation is not the appropriate route in this regard. Self-regulation through an international Code of Conduct would establish a well-functioning balance between the different interests of rating agencies, investors and issuers;
 - It is unclear that a requirement for CRAs to register would bring any direct benefit to investors;
 - European institutions must work closely with both IOSCO and the US authorities to ensure that any initiative is consistent with the global situation;
 - CRAs must have total freedom of expression and must be independent from political or business influences.

Detailed Comments

3. Much of the current interest surrounding CRAs arises from their perceived failure to identify problems in cases such as Enron and Parmalat. It is important to recognise that no specific operational failures by the CRAs have been identified in these cases. However, the FBE agrees that it is in the interests of European capital markets for the European institutions to look into possible measures in respect of the activities of CRAs subsequent to these cases. It is essential for the successful functioning of the markets that the rating procedure is based on an enduring mutual trust between the agencies on the one hand, and investors as well as issuers on the other.
4. CESR's call for evidence highlights many areas in which CRAs have already put in place strong internal best practice procedures. The FBE regards an international code of conduct for credit rating agencies, such as that under development by IOSCO, as an appropriate measure in this context. Only by adopting a global code will credit rating agencies be able to operate successfully on a global basis. By ensuring that any measures taken are consistent with the work of IOSCO and the US authorities, CESR would be recognising the importance of international markets for the funding of corporates and for investments.

Interests and conflicts of interest for Credit Rating Agencies

5. The FBE does not believe that CRAs should be prohibited from providing ancillary services to issuers to whom they also provide ratings. While it is conceivable that there could be a conflict of interest, rating agencies must develop strict controls such as Chinese Walls to prevent such conflict. CRAs must be obliged to disclose their policy in this respect and other services provided to rated issuers so that market participants can take account of this information in their considerations.
6. To date, the FBE has not seen evidence to suggest that ratings have been influenced by the fees paid by the rated company. We feel, therefore, that it is not certain that an obligation to disclose fees would benefit the market. CESR should look more closely into this issue. We do feel, however, that CRAs should disclose whether ratings are solicited or unsolicited as unsolicited ratings are based solely on publicly available information.
7. In theory, there is a risk that capital links or any other interest link between rated issuers and CRA's might influence the rating of these issuers. But, as with advisory services, it is sufficient that those links are disclosed so that market participants know about them and can make their own considerations.

The fair presentation of credit ratings

8. The FBE believes that the level of qualification of CRAs' staff is to a large extent regulated by the market. For CRAs to maintain credibility with issuers and other market participants they must ensure high quality staff. It would, therefore, be sufficient to include general principles in an international Code of Conduct.

9. The FBE is extremely concerned about the proposal to regulate the methodologies used by rating agencies. As stated in our introductory comments, we fully agreed with the position of the European Parliament's Own Initiative Report that there is a "need for total freedom of expression and for independence of the agencies whether from political or business influences." The EP goes on to say that "it is essential that the regulatory regime does not involve the fundamental credit judgement of the rating agencies or their independence". While measures may be helpful in respect of some areas of CRA activity, we feel strongly that the rating methodologies of the CRAs should continue to form the competitive basis of their business. It would be sufficient for CRAs to continue to disclose sufficient information about the methodologies and about particular rating results to allow market participants to make independent judgements on the reliability of rating decisions.
10. Regarding the publication of rating results, issuers should have the right and sufficient time to appeal a rating to a CRA. The time span for "the right of appeal" should be on the one hand sufficient so that any issuer can assess the rating result properly and on the other take into account the investors' right of information if a CRA changes its perception of a certain issuer or a certain security.

The relationship between issuers and rating agencies

11. CRAs should ensure that sufficient internal measures are taken so that confidential information supplied to them by issuers is not made public without the consent of the issuer. An international Code of Conduct should be very clear on this point.
12. Ratings should not be the result of a negotiation between a CRA and an issuer. However, it should be possible for issuers to ensure that a rating result is based on correct data, correct calculations and correct assessments. Therefore, there should be a dialogue between the issuer and the CRA.

Possible entry barriers to the market for the provision of credit ratings

13. While the FBE does not consider that there are currently significant barriers to entry for European CRAs, we are concerned that overly-prescriptive measures which go beyond the international Code of Conduct advocated in this paper would hinder expansion of European agencies on the global market or act as a deterrent to new entrants. We also feel that CESR should work closely with the SEC to resolve the issue of the NRSRO designation in the US which limits the recognition of other agencies.

The use of ratings in European legislation and in private contracts

14. The FBE does not believe that the use of ratings should become prevalent in EU legislation. This should be judged on a case by case basis and alternatives should be sought to keep the entry barriers to EU markets as low as possible.

15. The FBE does not see any reason for regulating the use of ratings in private contracts. Whether such contracts gain a higher market share will be determined by market forces. At present this is not the case.

Registration

16. As stated in the introductory comments, the FBE believes that it is unclear whether a registration system for CRAs would in any way benefit market participants. The proposal to put such a registration system in place should be subject to detailed consultation and cost/benefit analysis.