



Date: 15 May 2007

Ref: 07-304

**CESR's 2007 report on Credit Rating Agencies (CRA's):**

**Progress Report on CESR's dialogue with CRAs to review how the IOSCO code of conduct is being implemented.**

CESR published on December 2005 a voluntary framework to oversee compliance with the IOSCO Code (CESR 05-751). In summary, this framework includes three elements: (i) an annual letter from each Credit Rating Agency (CRA) to be sent to CESR, and made public, outlining how it had complied with the IOSCO Code and indicating any deviations from the Code; (ii) an annual meeting between CESR and the CRAs to discuss any issues related to implementation of the IOSCO Code; and (iii) CRAs would provide an explanation to the national CESR member where any substantial incident occur with a particular issuer in its market.

Moody's, Standard and Poors', Fitch Ratings and DBRS Limited are the CRAs that have currently chosen to adhere to the voluntary framework.

Subsequently, the European Commission published a Communication on 9 January 2006, where it expressed its intention to request CESR to report, on an annual basis, on the assessment of CRAs compliance of the IOSCO Code of conduct. Following the Commission's first request in June 2006, CESR provided in December its first report (CESR 06-545) including an analysis of the codes of the four CRAs that have chosen to adhere to the voluntary framework in relation to the IOSCO Code.

On 7 May 2007, CESR received a letter from the European Commission (attached) acknowledging the usefulness of CESR's 2006 report on CRAs' compliance with the IOSCO Code and formally requesting CESR prepare a second report by the end of this year.

This document sets out the annual letters of disclosure received by CESR from the CRAs for the 2007 report on their compliance with the IOSCO Code.

**Next steps:**

As CESR anticipated in its 2006 report, for Moody's, Standard and Poors', Fitch Ratings and DBRS Limited, this year CESR will look particularly into the areas of non compliance that were pointed out last year and will analyse any modifications in the provisions of the CRAs codes that have been introduced since then and the reasons for the change. Also, CESR intends to look into the forthcoming SEC implementing rules on the new US legislation on the rating business. In addition, CESR will monitor the IOSCO on going work to clarify some of the provisions of the IOSCO Code that were identified as generating confusion among regulators and CRAs.

As set out in the statement published in December 2005, CESR would welcome any other CRAs which would fall within the scope of the IOSCO Code and operating in the EU markets that wish to adhere to this voluntary framework, to indicate their interest to the CESR secretariat as soon as possible. For further information, please contact Raquel Garcia Alcubilla via email at [rgarcia@cesr.eu](mailto:rgarcia@cesr.eu) or by phone +34 91 585 16 01.



## **Annexes**

Letter received from European Commission

Letter to David Schroeder, Chief Operating Officer at Dominion Limited

Letter received from Dominion Limited

Letter to Richard Hunter Managing Director Regional Credit Officer for Europe, Middle East, Africa and Asia at Fitch Ratings

Letter received from Fitch Ratings

Letter to Raymond W. McDaniel, President and CEO of Moody's Corporation

[Letter received from Moody's\\*](#)

[Annex to letter received from Moody's\\*](#)

Letter to Kathleen Corbet, President of Standard and Poor's

Letter received from Standard and Poor's

\*Due to their size, these documents have not been included in this compilation. They can be accessed by clicking on the hyperlink, or through CESR's website in the section Expert Groups/Credit Rating Agencies.



## EUROPEAN COMMISSION

Internal Market and Services DG  
Director general

CESR
ARRIVE
ON: 07/05/07
N°: 07-281

Brussels, 26.04.07 1653  
Markt G3 FF/D (2007)

Mr Eddy Wymeersch  
Chairman  
CESR  
11-13 Avenue de Friedland  
75008 Paris - France

**Subject: Annual report on Credit Rating Agencies**

Dear Mr Wymeersch,

CESR's first monitoring report to the European Commission on the compliance of credit rating agencies (CRAs) with the IOSCO Code of December 2006 provided a very useful basis for the Commission to evaluate CRAs' compliance with the IOSCO Code. The survey on the day-to-day application of the IOSCO Code, in addition to the review of the codes of conduct of the respective CRAs, was particularly appreciated.

For now, the Commission believes that the case for new legislation remains unproven. However, considering the report's main conclusions, the Commission thinks that CRAs should continue their efforts to comply with all the Code's provisions and the Commission will be pushing for improvements in these areas of CRAs' activities where shortcomings, in particular the management of conflicts of interest in relation to CRAs' ancillary services and the transparency regarding unsolicited ratings, have been identified. Moreover, the Commission will continue to monitor the global development of the rating business.

As part of the Commission's approach, I would like to ask CESR to prepare a second report on CRAs' compliance with the IOSCO Code by the end of this year. First of all, the report should highlight the changes in the internal codes of conduct of CRAs vis-à-vis the IOSCO Code and the developments regarding the deviations identified in the 2006 report. It would also be useful if CESR could address specifically in its report the rating process as regards structured finance instruments (e.g. quality of rating process, conflicts of interest). An analysis of the CRAs' actual responses to prevailing market developments (like the current concerns associated with the sub-prime mortgage market) may be helpful in this context. An assessment of the level of day-to-day application of the IOSCO Code provisions by the CRAs on the basis of a survey of all stakeholders would be another important element of the second report of CESR.

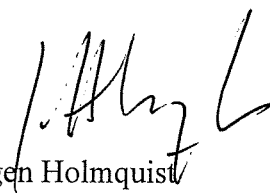
J:\A FS 80 SECURITIES\FS 80.50 RATING AGENCIES\50.2 CESR Working Group\FS 50.2 ARCHIVE

Commission européenne, B-1049 Bruxelles / Europese Commissie, B-1049 Brussel - Belgium. Telephone: (32-2) 299 11 11.

[http://ec.europa.eu/internal\\_market/](http://ec.europa.eu/internal_market/)

Finally, it would be appreciated if CESR could provide its views on the impact of global regulatory developments, in particular the new US legislation and implementing rules, on the rating business in the EU.

Yours sincerely,



Jörgen Holmquist

Contact:

Felix Flinterman, Telephone:(32-2) 299 69 57, [Felix.Flinterman@ec.europa.eu](mailto:Felix.Flinterman@ec.europa.eu)



Ref.: CESR/07-276

David Schroeder  
Chief Operating Officer  
DBRS Limited  
DBRS Tower 181 University Avenue, Suite 700  
Toronto, ON M5H 3M7  
Canada

Stockholm, 2 May 2007

**Re: CESR and Credit Rating Agencies**

Dear Mr Schroeder,

As you are aware, CESR published on December 2005 a voluntary framework to oversee compliance of the credit rating agencies (CRAs) with the IOSCO Code (CESR 05-751). This framework included the following aspects:

- The reception of an annual letter from each CRAs that will be made public and will explain how it has complied with the code and will also indicate any deviations from the Code.
- The organisation of a meeting with the CRAs to discuss any issues that might have arisen in relation to the implementation of the IOSCO Code.
- The explanation to the local CESR member of any substantial incident that might occur with an issuer.

Subsequently, the European Commission published a Communication on 9 January 2006, where it expressed its intention to request CESR to report, on an annual basis, on the assessment of CRAs compliance of the IOSCO Code of conduct. Following the Commission's first request in June 2006, CESR provided in December its first report (CESR 06-545).

Now the Commission is about to ask CESR to prepare a second report on CRAs' compliance with the IOSCO Code by the end of the year.

To undertake this assessment CESR has created a task force that will be chaired by Ms Ingrid Bonde, Director General of the Swedish Finansinspektionen and supported by Raquel Garcia Alcubilla from the CESR secretariat.

CESR has set the following indicative timetable for this task:

- May: the CESR task force will analyse the CRAs' annual letter/report on compliance with the IOSCO Code.
- June: the CESR task force will meet with CRAs.
- July-September: public consultation, if deemed necessary.



- September-October: drafting of the report.
- December: approval of the report by CESR and submission to the European Commission.

In order to meet the Commission's request, and following the voluntary framework agreed with you, I kindly invite you to send to the CESR Secretariat by noon 11 May, a letter, that will be made public in the CESR website, explaining how your organisation is complying with the IOSCO Code of Conduct and indicating any deviations from the Code.

Since in our 2006 report we already provided a thorough analysis of all the provisions of your code of conduct as compared to the IOSCO Code provisions, it is CESR's intention to use last years' report as departing point. Therefore, in order to ease our work and provide clarity to market participants, I would encourage you to follow this structure:

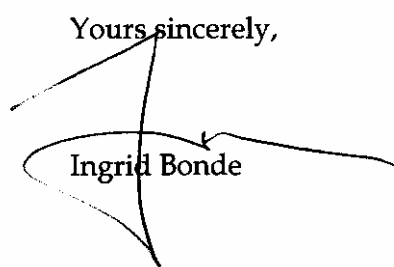
- Individual identification of the provisions of your code (with a cross reference to the IOSCO Code provision that it implements) that have been modified and explanation of the reasons for the change. In addition, a statement in relation to the fact that the other provisions of your code have not been amended would be appreciated to provide clarity in this respect.

- Individual identification of the aspects mentioned in CESR's report as areas of non compliance for your organisation, with a detail explanation of any changes made in relation to them (if not explained previously) or the reasons why no modifications have been made at this stage.

In addition, I inform you that the meeting between representatives of your organisation and CESR will take place in Stockholm around the end of June (the expected date is 29 June 2007, but it will be confirmed shortly). Prior to the meeting, we will circulate an agenda, including the specific issues that CESR members would be interested in discussing with you. In order to ease the meetings, written prior responses might be requested.

Should you need any further information on the above, please do not hesitate to contact Fabrice Demarigny or Raquel Garcia (+ 34 91 585 16 01; [rgarcia@cesr.eu](mailto:rgarcia@cesr.eu)).

Yours sincerely,



Ingrid Bonde



*Insight beyond the rating.*

May 10, 2007

The Committee of European Securities Regulators ("CESR") Secretariat  
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75008 Paris  
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DBRS Tower  
181 University Avenue  
Suite 700  
Toronto, ON M5H 3M7  
TEL +1 416 593 5577  
FAX +1 416 593 8432  
www.dbrs.com

Dear CESR Secretariat:

**Re: Report on Compliance to the DBRS Code of Conduct**

DBRS<sup>1</sup> is pleased to provide this second annual report ("Report") on compliance to the DBRS Code of Conduct ("Code").

DBRS has continued to follow and comply with its Code that was published in February 2006. The Code reflects DBRS's adherence to the International Organization of Securities Commissions ("IOSCO") Code of Conduct Fundamentals for Credit Rating Agencies ("IOSCO Code").

As of this Report date, DBRS has made no modifications to its published Code. There have been no significant areas of non-compliance by DBRS staff.

In December 2006, CESR published its Report to the European Commission on the compliance of Credit Rating Agencies ("CRAs") with the IOSCO Code ("CESR's Report"). CESR's report indicated that the CRAs<sup>2</sup> complied to a large extent with the IOSCO Code. It also highlighted certain deviations by DBRS from the IOSCO Code as well as areas for improvement. To assist in drafting their final report, DBRS provided comments to CESR at that time.

In February 2007, the IOSCO Technical Committee published a Consultation Report ("Consultation Report") on implementation of the IOSCO CRA Code. The Consultation Report indicated similar deviations as CESR's Report noting that a deviation was not considered to be a non-implementation of a particular IOSCO provision or non-compliance with the IOSCO Code. The Consultation Report considered DBRS to have strong functional implementation. DBRS has provided comments to the IOSCO Technical Committee in a letter for external publication.

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<sup>1</sup> DBRS operates outside Canada through various affiliated companies. Please note that effective January 22, 2007, "Dominion Bond Rating Service Limited" changed its name to "DBRS Limited", and "Dominion Bond Rating Service, Inc." changed its name to "DBRS, Inc.". There was no name change to DBRS (Europe) Limited.

<sup>2</sup> As of CESR's December 2006 Report only four credit rating agencies (DBRS, Fitch, Moody's and S&P) had published an IOSCO based Code of Conduct.



On an ongoing basis, DBRS reviews its policies, procedures and internal controls and accordingly makes adjustments to ensure that it continues to meet regulatory and legal requirements in the various jurisdictions DBRS does business. The Code serves to provide a summary of what DBRS has in place to ensure the objectivity and integrity of its ratings and transparency of its operations on a global basis.

As CESR may be aware, the United States (“U.S.”) Securities Exchange Commission (“SEC”) is in process of finalizing their proposed Nationally Recognized Statistical Rating Organization (“NRSRO”) rules following implementation of the U.S. Credit Rating Agency Reform Act of 2006. This will require, among other areas, adjustments to the Code.

Accordingly, DBRS will be revising its Code to concurrently meet the new SEC NRSRO rules and to address the deviations and areas of improvement noted in CESRs Report and the Consultation Report including the following IOSCO provisions, among other changes:

- 2.5 regarding ancillary services vis a vis impact assessment services (subject to our comments in the next paragraph);
- 2.12 regarding analyst involvement in fee discussions;
- 2.13 regarding rated securities owned by analysts prior to beginning employment with DBRS (“Grandfathered Securities”); and
- 3.9 regarding unsolicited ratings (also referred to as Ratings Based on Public Information; subject to our comments in the next paragraph).

DBRS wishes to note that it would be helpful to CRAs and market participants if there was more clarity or common definitions in the IOSCO Code for the following terms: “ancillary services” noting that CRAs do not consider impact assessment services as such; and “unsolicited ratings” noting that the IOSCO Code does not define this term. More clarity on what is meant by these terms in the IOSCO Code would serve to drive consistency in understanding and improved assessment as to whether CRAs actually deviate from these particular provisions.

DBRS is currently working on revising the Code and expects to externally publish this revised Code in the next several months and we will notify CESR as soon as this is done.

As outlined in its letter to the IOSCO Technical Committee, DBRS endorses widespread public adoption of an IOSCO CRA Code by rating agencies of all sizes and business models and we suggest that this is an achievable goal given the principles based comply or explain approach. The IOSCO CRA Code is a self-regulatory framework that provides transparency to market participants about a rating agency’s quality, integrity and independence. Having all rating agency participants ascribe to it helps to promote the safety and soundness of the credit rating industry and also helps to strengthen competitiveness within the industry. We would suggest that CESR seek public consultation on this aspect for purposes of their December 2007 report.





DBRS looks forward to meeting with CESR members to discuss the Code in the near future.

Sincerely yours,

A handwritten signature in black ink, appearing to read "M Keogh", is positioned below the "Sincerely yours," text.

Mary Keogh  
Managing Director, Policy & Regulatory Affairs

A handwritten signature in blue ink, appearing to read "Kent Wideman", is positioned below the Mary Keogh signature.

Kent Wideman  
Group Managing Director, Policy & Rating Committee

CC:  
David Schroeder, Chief Operating Officer



Ref.: CESR/07-277

Richard Hunter  
Managing Director  
Regional Credit Officer for Europe, Middle East,  
Africa and Asia  
Fitch Ratings  
101 Finsbury Pavement London EC2A 1RS  
United Kingdom

Stockholm, 2 May 2007

**Re: CESR and Credit Rating Agencies**

Dear Mr Hunter,

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Subsequently, the European Commission published a Communication on 9 January 2006, where it expressed its intention to request CESR to report, on an annual basis, on the assessment of CRAs compliance of the IOSCO Code of conduct. Following the Commission's first request in June 2006, CESR provided in December its first report (CESR 06-545).

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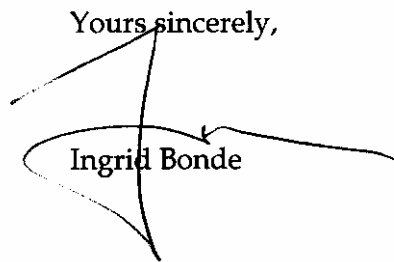
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Should you need any further information on the above, please do not hesitate to contact Fabrice Demarigny or Raquel Garcia (+ 34 91 585 16 01; [rgarcia@cesr.eu](mailto:rgarcia@cesr.eu)).

Yours sincerely,



Ingrid Bonde



101 Finsbury Pavement  
London, EC2A 1RS, England

[www.fitchratings.com](http://www.fitchratings.com)

May 10, 2007

**BY ELECTRONIC MAIL AND POST**

Ms Ingrid Bonde  
Chair  
Task Force on Credit Rating Agencies  
The Committee of European Securities Regulators (CESR)  
11-13 avenue de Friedland  
75008 Paris  
France

Dear Ms Bonde,

**The 2007 CESR Review of Credit Rating Agencies**  
**Fitch Ratings and its Compliance with the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies**

Thank you for your letter dated May 2, 2007, which (i) provided notice of the start of the 2007 CESR review of credit rating agencies, (ii) set out an indicative timetable for the process, and (iii) as a first step requested details of how Fitch Ratings is complying with the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies (the "IOSCO Fundamentals"), and of any deviations from the IOSCO Fundamentals that may exist. In structuring our response to (iii), we note your request that we take as a starting point the conclusions of the 2006 report by CESR to the European Commission on the compliance of our agency with the IOSCO Fundamentals and, in particular, the areas of our Code of Conduct (our "Code") where CESR believed our approach differed to the IOSCO Fundamentals.

**Overall Findings of the 2006 CESR Report**

We welcome CESR's conclusion that our Code complies to a large extent with the provisions of the IOSCO Fundamentals. We also welcome CESR's recognition of the "comply and explain" nature of the IOSCO Fundamentals.

We note that CESR's findings are broadly consistent with the observations in IOSCO's own draft "Consultation Report on the Review of Implementation of the IOSCO Fundamentals of a Code of Conduct for Credit Rating Agencies" ("CRI Report") published in February 2007, which concluded that Fitch was amongst the CRAs with "*strong implementation*" of the IOSCO Fundamentals within its own Code. For your information, we have attached to this letter our response to the CRI Report, clarifying the language of Fitch's policies with regard to one point and the location of a policy statement with regard to another.

**Specific Areas Identified within the 2006 CESR Report**

Since the publication of the findings of the 2006 CESR report, just four months ago, we have not made any changes to our Code. Consequently, as noted in our letter to you dated May 12, 2006, and as stated

on page 12 of our Code, there is only one area in which we believe that our policies and procedures differ somewhat from the IOSCO Fundamentals.

***IOSCO Provision 2.12: Fee Discussions with Issuers***

Specifically, provision 2.12 of our Code allows for the fact that business requirements sometimes dictate that certain members of senior management, or certain employees with specialist language skills, must assist in fee discussions while at the same time possibly participating in rating discussions. As we discussed during our meeting last June in Stockholm, such occurrences have fallen in number as we have invested in expanding our business development team, but it is not currently practical or cost effective for Fitch to completely discontinue this practice. Nonetheless, we believe that this approach is consistent with the spirit of provision 2.12 of the IOSCO Fundamentals since those participating in such rating discussions are sufficiently senior to manage any conflicts of interest that may arise. We would also note that we have received no complaints from the marketplace with regard to this deviation, which seems to be well-understood.

***IOSCO Provision 2.5: Ancillary Services/Separation of Operations***

CESR's 2006 report also questioned the application of provision 2.14 of our Code, which addresses the points raised in provision 2.5 of the IOSCO Fundamentals. Our Code provision states that "*Fitch shall separate, both operationally and legally, its rating business and analysts from any of its other businesses that may present a conflict of interest.*"

We note that CESR's concerns over the operational and legal separation of our ratings and non-ratings business were based on two elements. First, a suggestion that rating assessment services ("RAS") could be considered as a non-ratings business and, as such, should be legally and operationally separated from our ratings business; and secondly, an observation that Valuspread, an independent CDS price reporting service, is a division within Derivative Fitch (a ratings business) and is thus inconsistent with provision 2.5 of the IOSCO Fundamentals.

With regard to the first point, we have always considered, and continue to consider, that our RAS is an integral part of our ratings business. Issuers and their advisers assign significant value to receiving these scenario-based opinions of creditworthiness from the same analytical team that provides all other opinions of creditworthiness. We would additionally note that our interpretation on this matter has recently been confirmed by IOSCO itself, possibly in response to the request by CESR to do so in paragraph 53 of CESR's 2006 Report. In discussing RAS in its February 2007 CRI Report, IOSCO stated that the "*...IOSCO CRA Code...explicitly contemplates CRAs providing such services [rating assessment services], and explicitly contemplates that such services might typically fall under the ambit of the CRA's analytical staff.*"

Given that IOSCO's recent commentary would appear to have provided clarity on the definitional point, according to paragraph 43 of CESR's 2006 Report, CESR's primary concern would now appear to lie with the absence of specific, separate details within our Code concerning the management of potential conflicts of interest with regard to RAS. We would note on this point that, as an integral part of our ratings business, our Code (and related policies) applies, thus potential conflicts are managed consistently with the approach taken in the rest of our rating operations.

With reference to paragraph 42 of CESR's 2006 report, we also note that some confusion has arisen with regard to structured finance ratings. Clearly, any structured finance rating is a hypothetical scenario until the transaction is created. This does not, however, correspond to the market understanding of the term "Rating Assessment Service", which is typically reserved for reference to hypothetical opinions in the case of corporate and public finance ratings. Moreover, we would also point out that our analysis with respect to structured finance ratings does not involve us "negotiating" with an issuer. The issuer/its

representatives will present us with their proposed structure, and we provide our reaction to that structure from a ratings perspective; the issuer is then free to modify its structure or not. We simply provide our reaction to structures presented to us.

With regard to CESR's comments concerning Valuspread, we note that the language of our Code and of the IOSCO Fundamentals specify separation of rating businesses from any other businesses "*that may present a conflict of interest*", and not simply from any other non-ratings business. As an independent price reporting service, we see no potential conflict of interest arising with our ratings business. As noted in previous communications with you, we would highlight that the operation of Valuspread is nonetheless managed in accordance with our Firewall Policy for non-ratings businesses. In light of these points, we do not feel it is necessary to revise our Code in response to CESR's conclusions regarding provision 2.5, or to regard and report the operation of Valuspread as an exception to either our Code or to the IOSCO Fundamentals.

***IOSCO Provision 3.9: Disclosure of Non-Analytical Information***

Finally, CESR's 2006 report suggested that Fitch's policies on the disclosure of unsolicited ratings, referred to under provision 2.6 of Fitch's Code, are inconsistent with provision 3.9 of the IOSCO Fundamentals. As a first principle we would note, as CESR itself notes in the table of its 2006 report, that Fitch does, in fact, disclose both initiation and participation for all published ratings, as well as its policy on this topic. This conforms fully with the wording of IOSCO provision 3.9. Both Fitch's policy document and details of the initiation and participation status of individual ratings are available on an ongoing basis from Fitch's free access public website and from its free access public Ratings Desk.

We note that IOSCO itself does not prescribe a medium or frequency of disclosure, either in the original IOSCO Fundamentals or in its post-implementation CRI Report of February 2007. As a result, it remains unclear to us from CESR's 2006 report in what way our Code and practices are considered by CESR not to conform to provision 3.9 of the IOSCO Fundamentals.

To the extent that CESR has its own views on these, or any other topics surrounding unsolicited ratings not covered in the IOSCO Fundamentals, Fitch is happy to receive CESR's feedback as part of its commitment to ensuring that its disclosures reflect the nature of the rating opinions published.

I hope that this information will be useful to you and your colleagues on the CESR Task Force. If you would like any further clarification, please do not hesitate to contact me on +44 20 7417 4362, richard.hunter@fitchratings.com, or my colleague Sharon Raj on +44 207 417 6341, sharon.raj@fitchratings.com. Otherwise, I look forward to a constructive and open dialogue with you during our scheduled meeting at your offices in June.

Yours sincerely,



**Richard Hunter**  
Managing Director  
Regional Credit Officer for Europe,  
Middle East, Africa and Asia



Ref.: CESR/07-278

Raymond W. McDaniel  
President and Chief Executive Officer  
Moody's Corporation  
99 Church Street  
New York  
NY 10007  
USA

Stockholm, 2 May 2007

**Re: CESR and Credit Rating Agencies**

Dear Mr McDaniel,

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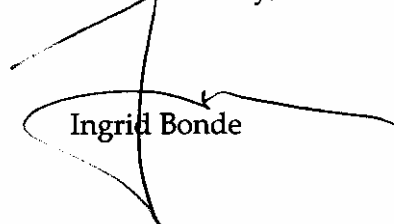
- Individual identification of the provisions of your code (with a cross reference to the IOSCO Code provision that it implements) that have been modified and explanation of the reasons for the change. In addition, a statement in relation to the fact that the other provisions of your code have not been amended would be appreciated to provide clarity in this respect.

- Individual identification of the aspects mentioned in CESR's report as areas of non compliance for your organisation, with a detail explanation of any changes made in relation to them (if not explained previously) or the reasons why no modifications have been made at this stage.

In addition, I inform you that the meeting between representatives of your organisation and CESR will take place in Stockholm around the end of June (the expected date is 29 June 2007, but it will be confirmed shortly). Prior to the meeting, we will circulate an agenda, including the specific issues that CESR members would be interested in discussing with you. In order to ease the meetings, written prior responses might be requested.

Should you need any further information on the above, please do not hesitate to contact Fabrice Demarigny or Raquel Garcia (+ 34 91 585 16 01; [rgarcia@cesr.eu](mailto:rgarcia@cesr.eu)).

Yours sincerely,



Ingrid Bonde





Ref.: CESR/07-275

Kathleen Corbet  
President  
Standard & Poor's  
55 Water Street  
New York  
NY 10041-0003  
USA

Stockholm, 2 May 2007

**Re: CESR and Credit Rating Agencies**

Dear Ms Corbet,

As you are aware, CESR published on December 2005 a voluntary framework to oversee compliance of the credit rating agencies (CRAs) with the IOSCO Code (CESR 05-751). This framework included the following aspects:

- The reception of an annual letter from each CRAs that will be made public and will explain how it has complied with the code and will also indicate any deviations from the Code.
- The organisation of a meeting with the CRAs to discuss any issues that might have arisen in relation to the implementation of the IOSCO Code.
- The explanation to the local CESR member of any substantial incident that might occur with an issuer.

Subsequently, the European Commission published a Communication on 9 January 2006, where it expressed its intention to request CESR to report, on an annual basis, on the assessment of CRAs compliance of the IOSCO Code of conduct. Following the Commission's first request in June 2006, CESR provided in December its first report (CESR 06-545).

Now the Commission is about to ask CESR to prepare a second report on CRAs' compliance with the IOSCO Code by the end of the year.

To undertake this assessment CESR has created a task force that will be chaired by Ms Ingrid Bonde, Director General of the Swedish Finansinspektionen and supported by Raquel Garcia Alcubilla from the CESR secretariat.

CESR has set the following indicative timetable for this task:

- May: the CESR task force will analyse the CRAs' annual letter/report on compliance with the IOSCO Code.
- June: the CESR task force will meet with CRAs.
- July-September: public consultation, if deemed necessary.



- September-October: drafting of the report.
- December: approval of the report by CESR and submission to the European Commission.

In order to meet the Commission's request, and following the voluntary framework agreed with you, I kindly invite you to send to the CESR Secretariat by noon 11 May, a letter that will be made public in the CESR website, explaining how your organisation is complying with the IOSCO Code of Conduct and indicating any deviations from the Code.

Since in our 2006 report we already provided a thorough analysis of all the provisions of your code of conduct as compared to the IOSCO Code provisions, it is CESR's intention to use last years' report as departing point. Therefore, in order to ease our work and provide clarity to market participants, I would encourage you to follow this structure:

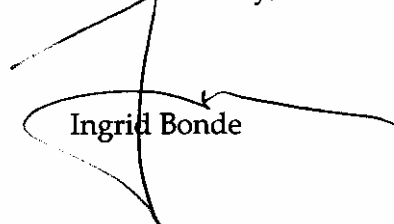
- Individual identification of the provisions of your code (with a cross reference to the IOSCO Code provision that it implements) that have been modified and explanation of the reasons for the change. In addition, a statement in relation to the fact that the other provisions of your code have not been amended would be appreciated to provide clarity in this respect.

- Individual identification of the aspects mentioned in CESR's report as areas of non compliance for your organisation, with a detail explanation of any changes made in relation to them (if not explained previously) or the reasons why no modifications have been made at this stage.

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Should you need any further information on the above, please do not hesitate to contact Fabrice Demarigny or Raquel Garcia (+ 34 91 585 16 01; [rgarcia@cesr.eu](mailto:rgarcia@cesr.eu)).

Yours sincerely,



Ingrid Bonde

11 May 2007

Ms. Ingrid Bonde  
c/o CESR  
11-13 avenue de Friedland  
75008 Paris  
France

*Via e-mail : secretariat @ cesr-eu.org*

Dear Ms Bonde:

Thank you for your letter dated 2 May 2007 providing an indicative timetable for the work of the CESR task force on credit rating agencies.

Standard & Poor's Ratings Services ("Ratings Services") looks forward to continuing to engage with the CESR task force as it works towards preparation of its second annual report to the European Commission on CRAs' compliance with the December 2004 IOSCO Code of Conduct Fundamentals for Credit Rating Agencies ("the IOSCO Code").

Ratings Services continues to support the essential purpose of the IOSCO Code, that is, to promote investor protection by safeguarding the integrity of the rating process, bearing in mind at all times the "*comply or explain*" nature of the IOSCO Code.

Ratings Services' Code of Conduct ("the Ratings Code of Conduct") was adopted in October 2005 in order to demonstrate the alignment of Standard & Poor's policies and procedures with the IOSCO Code.

In addition to the Ratings Code of Conduct, Ratings Services last year published a Report on the Implementation of Standard & Poor's Ratings Services Code of Conduct ("Implementation Report"). Both the Ratings Code of Conduct and the Implementation Report continue to be publicly available on Standard & Poor's website (an enhanced version of the website was launched in December 2006.<sup>1</sup>)

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<sup>1</sup> <http://www.standardandpoors.com>

Ratings Services recognises its role in the global capital markets and is committed to providing ratings that are objective, independent and credible. The Ratings Code of Conduct, together with Ratings Services criteria, methodologies, policies, practices, and procedures and the publication of reports, analyses, studies and articles, seeks to protect the integrity of the rating process, promote transparency and safeguard confidential information.

Since the Ratings Code of Conduct was published in 2005, Ratings Services has kept under review its policies and procedures as part of its process for implementing the Ratings Code of Conduct. These policies and procedures are dynamic and Ratings Services intends to continue its review to further promote the objectivity, independence and credibility of its ratings, the transparency of its ratings processes and the protection of confidential information. As part of its continuing evaluation of its policies and procedures, Ratings Services takes very seriously any feedback it receives from ratings users, including regulators, regarding interpretation and implementation of the Ratings Code of Conduct on a day-to-day basis.

In accordance with the suggestion on the second page of your letter, and on the basis that there have been no changes to the Ratings Code of Conduct since its inception, I now address specific issues regarding Ratings Services' compliance with the IOSCO Code which CESR identified in its report to the European Commission dated December 2006 (ref CESR/06-545) ("the CESR report").

Ratings Code of Conduct provision 1.15: The reporting lines and compensation of the Executive Vice President

The CESR report indicated that Code of Conduct provision 1.15 "*seems to contradict*" provision 1.15 of the IOSCO Code.

By way of background, we would explain that Standard & Poor's has in place a separate compliance function to service its different businesses (including Ratings Services), namely the Global Regulatory Affairs Department. This compliance oversight function is completely independent of those who vote on ratings and conduct ratings analysis. The Analytics Policy Board ensures ongoing compliance with analytical and ratings quality standards within Ratings Services.

As outlined in the Ratings Code of Conduct, the Analytics Policy Board and the Executive Managing Directors of Ratings Services have been tasked with enforcement of the Ratings Code of Conduct in relation to analytical matters. The Global Regulatory Affairs Department has been tasked with enforcement of the Ratings Code of Conduct in relation to all other matters. Both advise the Executive Vice President in charge of Ratings Services concerning matters of Ratings Code of Conduct enforcement. The Executive Vice President reports to the President of Standard & Poor's.

The Executive Vice President is not involved in the day-to-day rating activities of Ratings Services and does not sit on rating committees. Moreover her reporting lines are independent of Ratings Services operations and her compensation is determined by the executive leadership of Standard & Poor's and approved by management of The McGraw-Hill Companies, Inc. ("McGraw-Hill") (of which Standard & Poor's is a wholly-owned division out of which Ratings Services conducts business) and the Compensation Committee of the Board of Directors of McGraw-Hill.

Our view has been that this arrangement serves to address the issues which IOSCO Code provision 1.15 was designed to deal with and in particular the need to ensure that *"the compensation and reporting lines of the person in charge of the CRA's compliance program is not dependent on or influenced by any issuer, client, or group of issuers or clients"*. We believe that there should be some recognition that – ultimately – compliance personnel cannot be completely insulated from their employer's economic performance. To this end, we welcome the suggestion (at page 78 of the CESR report) that this issue might usefully be clarified in the IOSCO Code.

I should add that, as part of our ongoing efforts to ensure the most appropriate oversight of compliance matters and to take account of current regulatory initiatives, we have created a new role, that of Chief Compliance Officer, responsible for monitoring the regulatory compliance programme for Ratings Services globally. The Chief Compliance Officer position will report into the head of the Global Regulatory Affairs Department, which oversees regulatory and compliance matters for Standard & Poor's global operations.

As a result of the creation of this new role, we intend to make the necessary consequential changes to the Ratings Code of Conduct to reference this role and thereby to underline Ratings Services' commitment to align as fully as possible its policies and procedures with the IOSCO Code.

#### Ratings Code of Conduct provision 2.5: Independence and avoidance of conflicts of interest

The CESR report determined that Ratings Services was not fully compliant with IOSCO Code provision 2.5, which stresses the importance of the legal and operational separation of CRAs' credit rating businesses from any other businesses that may present a conflict of interest.

At a high level, we have explained in the Ratings Code of Conduct that, although Ratings Services is not a separate legal entity within The McGraw-Hill Companies, Inc., it is the effective operational separation in place between Ratings Services and other Standard & Poor's and McGraw-Hill businesses that enables Ratings Services to comply effectively with the spirit of the IOSCO Code in general and provision 2.5 in particular. Specifically Ratings Services has implemented a

firewall policy to ensure that the rating and surveillance processes are not compromised by conflicts of interest, abuse of confidential information or any other improper influence.

Moreover Standard & Poor's has had in place, for many years, firewalls among business units to safeguard the independence of ratings services. Ratings Services must exercise their editorial and analytic opinions independent from other businesses, such as Equity Research or Index Services. In addition, where Ratings Services receives non-public information, it has in place processes to make sure that the information does not become public and that it is not otherwise disseminated. Standard & Poor's relies on the McGraw-Hill Code of Business Ethics and the Ratings Code of Conduct (and its precursors) to formalise the functional and physical separation of business units.

For the above reasons and in view of the global scope of McGraw-Hill and Standard & Poor's operations, we have not taken steps to re-configure Ratings Services as a separate legal entity, a decision which entails substantial accounting and tax considerations.

As to the categorisation of "*rating assessment services*" as ancillary services or otherwise, it is Ratings Services' view that they should not be so classified, as is (we suggest) explicitly contemplated by provision 1.14 of the IOSCO Code.

We note in this regard that IOSCO, at page 17 of its February 2007 Consultation Report, is of the opinion that rating assessment services "*might typically fall under the ambit of the CRA's analytical staff*" and that there have been differing views as to what services might constitute ancillary services.

We agree with IOSCO's view (as expressed in its Consultation Report) that defining "*ancillary services*" would not necessarily sit comfortably with the flexible and principles-based nature of the IOSCO Code. We are also of the view that the answer to CESR's suggestion that the IOSCO Code be clearer on the question of whether rating assessment services are "*ancillary services*", is to acknowledge that rating assessment services are typically part of CRAs' analytical rating services and are not "*ancillary services*". We believe this approach provides the clarification both CESR and IOSCO seek. The rating assessment services, as well as other analytic services provided by Ratings Services, are viewed as "*ratings related*" as these services are entirely consistent with the rating methodology. We believe Ratings Services' policies and procedures for ratings assessment services (which Ratings Services terms Ratings Evaluation Service) adequately manage any conflicts arising from providing these services.

Ratings Code of Conduct provision 3.9: Ratings not initiated at the request of the issuer

The CESR report suggests that Ratings Services is not fully compliant with provision 3.9 of the IOSCO Code. Indeed in its Ratings Code of Conduct, Ratings Services identified that this was one of two areas in which Ratings Services' Code provisions differed from the provisions of the IOSCO Code – although we note that IOSCO, at page 12 of its Consultation Report found that, in the context of unsolicited ratings, "*S&P's approach does not seem to be an actual variation*".

Ratings Services makes its ratings and ratings actions available to the public without charge via real-time posts on Standard & Poor's public website and by dissemination to the news media. Members of the public may obtain a current public rating for any issuer or issue without charge by registering on the public website or by telephone. Standard & Poor's also provides ratings information via electronic or print subscription services.

Most ratings are solicited by the issuer and involve issuer participation. In circumstances where it considers that it has sufficient information to be able to reach a robust credit opinion, Ratings Services may issue unsolicited ratings, which may not involve issuer participation. Ratings Services uses the following disclaimer for all of its unsolicited ratings:

*"This rating was initiated by Standard & Poor's Ratings Services and may be based solely on publicly available information and/or may not involve the participation of the issuer's management".*

Ratings Services also issues, as a subset of unsolicited ratings, ratings referred to as "*pi*" or "*public information*" ratings. These are assigned only to issuers, not to issues, and they do not generally incorporate ratings modifiers (+ and -). These ratings do not carry outlooks, nor are they subject to CreditWatch. The "*pi*" subscript appears with each such rating and signifies that the rating is based on an analysis of an issuer's published financial information, as well as additional information which is in the public domain. They do not reflect in-depth meetings with an issuer's management and are therefore based on less-comprehensive information than ratings without a "*pi*" subscript.

We continue to work on ways to ensure that ratings are consistently identified as being unsolicited by appropriate identifiers in the various delivery platforms used by Ratings Services - in order to enhance the levels of information available to investors.

We hope that any additional identifiers which are necessary will be incorporated in relevant delivery platforms this summer. As mentioned above, our "*pi*" ratings are currently identified with a "*pi*" subscript and other CRA initiated unsolicited ratings will be identified with "*(Unsolicited)*". It is important to note that, other

than the “*p*” ratings, we do not issue any unsolicited ratings in the European Union.

We now turn to points of possible improvement of the IOSCO Code (as referred to on pages 78 and 79 of the CESR report) and the reference to Ratings Services’ incorporation of a six month quarantine period into provision 2.13 (c) of its Ratings Code of Conduct. Our view is that a specific quarantine time between analyst past employment with a rated entity and working on that rating should not be specified as CESR suggests. Such an approach appears too prescriptive and does not sit comfortably with the principles-based approach of the IOSCO Code. From Ratings Services’ perspective, based on long experience, the six month quarantine period is sufficiently long. We also observe that seeking to extend and prescribe the time of such quarantine time could hurt smaller CRAs with fewer staff.

We look forward to continuing to discuss these matters of mutual interest with you and your colleagues in the coming months. We also welcome the suggestion that you will let us know, in advance of any meeting, if there are any specific issues which CESR members would be interested in discussing with us. In this regard, we note the general reference at paragraph 57 of the CESR report to transparency of CRA methodologies and would be pleased to discuss this point further with you.

Yours faithfully,

A handwritten signature in blue ink, reading "Kathleen A. Corbet". The signature is fluid and cursive, with the first name "Kathleen" being more prominent than the last name "Corbet".

Kathleen A. Corbet  
President  
Standard & Poor’s

cc: Raquel Garcia, CESR