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Press Release
European Commission Issues an Additional Request to Review the Role of Credit Rating Agencies

On Tuesday 11 September 2007, Mr Eddy Wymeersch, Chair of CESR, Ms Ingrid Bonde, Chair of CESR's Task Force on Rating Agencies, and Fabrice Demarigny, Secretary General of CESR, met Commissioner Charlie McCreevy and his staff in Brussels.

CESR presented the work underway to monitor the compliance by credit rating agencies with the 'IOSCO Code of Conduct Fundamentals For Credit Rating Agencies' and updated the Commission on progress made on the in-depth study of rating of structured finance products. This study follows findings by CESR during its first review of the application of the Code by rating agencies under its voluntary framework. This was published on 4 January 2007. In addition, CESR received a letter from the European Commission on 7 May 2007, asking for further analysis to be undertaken in relation to structured finance.

CESR launched a Call for Evidence in the form of a questionnaire on 22 June 2007. The 'Call for Evidence' closed 10 September and the responses to the questionnaire are available on CESR's website (under the section consultations/past consultations and responses).

At the meeting on 11 September, Commissioner McCreevy expressed the wish to understand several aspects of the rating of structured finance products. These points are set out further in a letter that was given to CESR at the meeting, as an additional request to review the role of credit rating agencies. The letter is published as an annex to this statement.

CESR welcomes this added incentive to pursue its work on rating agencies. CESR has indicated it will submit its report on the application of the IOSCO Code by rating agencies by 30 April 2008. Following further consideration of the points raised in the letter, the timetable will be reviewed. Should further changes be considered necessary, CESR will communicate this through its website.

Notes for editors

1. Following a request by the European Commission for CESR to assess the treatment of Credit Rating Agencies (CRAs), CESR proposed a voluntary framework to monitor the application of the IOSCO Code by CRAs which was launched in December 2005.

2. 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.

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

4. In summary, this framework includes three elements: (i) an annual letter from each 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.

5. Following the Commission's first request in June 2006, CESR provided in its first report (Ref. CESR/06-545) published on 4 January an analysis of the codes of the four CRAs that have chosen to adhere to the voluntary framework in relation to the IOSCO Code.

6. In CESR's progress report of 15 May 2007 (Ref. CESR/07-304), CESR indicated that as part of its regular review it would look particularly into the areas of non-compliance that were highlighted in its first review (such as the quality of the rating process, conflicts of interest), and would analyse any modifications in the provisions of the CRA codes that have been introduced since the first review.

7. In June 2007, as part of the second review and following a letter from the European Commission received 7 May 2007, CESR launched a questionnaire regarding the Rating of Structured Finance Instruments. This call for evidence closed on 10 September. The responses are available on CESR's website under 'consultations'/'past consultations and responses'.

8. CESR is an independent Committee of European Securities Regulators. The role of the Committee is to:
   - Improve co-ordination among securities regulators;
   - Act as an advisory group to assist the EU Commission, in particular in its preparation of draft implementing measures in the field of securities;
   - Work to ensure more consistent and timely day to day implementation of community legislation in the Member States.
   - The Committee was established under the terms of the European Commission's decision of 6 June 2001 (2001/1501/EC). It is one of the two committees envisaged in the Final Report of the Group of Wise Men on the regulation of European securities markets. Baron Alexandre Lamfalussy chaired this group. The report itself was endorsed by the European Council and the European Parliament. The relevant documents are available on the CESR website.

9. Each Member State of the European Union has one member in the Committee. The members are nominated by the Member States and are the heads of the national public authorities competent in the field of securities. The European Commission has nominated the Director General of the DG Market, as its representative. Furthermore, the securities authorities of Norway and Iceland are also represented at a senior level.

10. For further information please contact:

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11.09.2007 D/001752

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Subject: Additional request to review role of credit rating agencies (CRAs)

Dear Eddy,

Considering the turmoil in the US sub-prime mortgage market, I would, as a matter of urgency, appreciate if CESR could specifically address the following points in its review of the rating process as regards structured finance instruments.

First of all, the interaction between rating analysts and arrangers of structured finance products: Critics stipulate that in playing an iterative guidance role – albeit an informal and unremunerated one - in their interactions with arrangers and investment banks on the design of the structured finance product, the independence of rating agencies and, consequently, the integrity of the rating and the process may be compromised, with the risk of rating agencies being pressured to compete with one another on the grading of particular structures.

As previously discussed, the business model of various CRAs - where issuers pay for the rating - constitutes a long recognised potential conflict of interest which might affect the independence of the rating process. It would be very helpful if CESR could carefully assess the extent to which CRAs follow the existing (IOSCO) Code and indicate whether – in the light of the substantial growth in rating of securitizations in recent years - this Code adequately and effectively addresses the potential conflicts of interest issue particularly in respect of securitization and structured credit. The conflict risks could have the potential to be more pronounced for securitization and structured credit than for the rating of conventional corporates. It would be helpful to focus on this latter issue because of the potential for a bigger stream of future earnings for a rating agency from an originator/issuer of securitized assets/structured finance than would be possible or likely from a more conventional corporate issuer. There is also the potential for rating agencies to compete in respect of the structures required for a given rating mix for individual securitization/structured finance issues.

The transparency of CRAs' rating methodologies and in particular the ability and ease with which investors have been able to track changes to those methodologies and to the series of changes to the assumptions used in their rating models are also issues of concern which I would like CESR to address. CRAs appear to have provided limited information about the key differences between the reliability of corporate and structured finance ratings. Therefore, it would be useful to understand how the transparency of the CRAs' rating process and their rating methodologies can be improved, and to have your views on whether the CRAs provided investors with adequate warnings about the limitations of the assumptions that were input into the rating models – such limitations being due possibly to the absence of sufficient historical data and experience on securities issues and structures of this kind over a number of credit cycles.

Doubts have also been raised about whether CRAs have adequate resources to understand the rapidly changing and growing complex structured finance market. For example, it has been argued that the high turnover of analysts within CRAs affects the quality of the rating decisions. In this regard it would be helpful to plot the growth in the amount and experience profile of professional human resources allocated by the rating agencies to rating securitized assets over the past ten years against the growth in the number of securitization issues rated by them over that time. In addition, trends in the pace of staff turnover at both credit committee level and analyst and trainee analyst levels below that level would be informative.

Furthermore, the apparently slow response of CRAs to the problems in the sub-prime mortgage business has raised concerns about the timeliness of rating decisions in the field of structured finance, especially as there has been ample evidence of a deterioration in this market since at least the second half of 2006, culminating in sizeable provisioning by leading market players in the first quarter of the current year. CESR's views on the quality of ratings and the timing of rating decisions - including the timing of decisions to put ratings on "watch"- would therefore also be very welcome. I would appreciate your views too as to whether regular (quarterly or half-yearly), formal and published reviews of all individual structured finance ratings might be necessary, even mandatory.

I believe that a thorough analysis is also warranted of the pace of grade migration in different classes of securities, including in particular the pattern and pace of migration in the years running up to a default. This is necessary in order to come to a view on the relevance of the "macro" default statistics provided by the rating agencies. Your views on the appropriateness of a volatility indictor being attached to the structured product ratings would also be helpful.

It would be helpful to get the views of CEBS on the role of CRAs within the context of the Basel II framework to see if there are further concerns.

Finally, as rating agencies make the argument that avoiding the risks of conflicts of interest is important from the perspective of protecting their long term franchise, an examination of their remuneration structures and those of their management hierarchy in their parent companies would be appropriate in order to establish whether the performance-linked aspects of the remuneration structure are sufficiently deferred to ensure that, having regard to the length of many credit cycles, there is indeed sufficient incentive for the long term value of the rating franchise to be at the forefront of their priorities when managing the business.

I would like to receive CESR's preliminary views and policy advice on these issues as soon as possible but in any event not later than April 2008 when CESR is due to present its already planned annual report of the role of CRAs' and their compliance with the IOSCO Code .

I would suggest CESR also consults the SEC on these questions which are, at the same time, subject to examination by the Commission services. I would appreciate if you would keep them and my cabinet informed about the progress of your review and the work methodologies you are pursuing.

In conclusion, let me say that I attach the utmost importance to this task and see it as a priority issue.

I am most grateful for your help.

Yours sincerely,

Charlie

Charlie McCreevy