THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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

Progress Report on CESR's dialogue with CRAs to fulfil the European Commission's request to review the role of CRAs as regards structure finance: list of questions for the CRAs.

As a follow up of the meetings held with rating agencies at the beginning of October and in order to obtain the necessary data to fulfil the European Commission's new request to review the role of CRAs with regards to structured finance, on 14 November CESR sent a letter asking for additional information to the 4 CRAs which have agreed to be part of CESR's voluntary framework.

CESR is publishing today the list of questions that has been submitted to the CRAs. Written responses have been requested by the end of November.

The questions deal mainly with the following areas of the structured finance market:
- Transparency of rating methodologies;
- Human resources allocated to rating and monitoring;
- Periodic monitoring of the ratings;
- Methodology changes;
- Potential conflicts of interest.

The responses to these questions, except those that are expressly requested by the CRAs to be kept confidential, will be made public and will constitute a main input for CESR's 2007 report.

Annex

Request for information sent by CESR to the 4 CRAs on 14 November 2007

Transparency of methodology

1. **Publication of methodologies and assumptions:**
   a. Is there a section on your website devoted to the publication of your methodologies?
   b. Do you provide explanations of the methodologies applied to the different categories of ratings for each asset class (e.g. RMBS, CDO, etc) separately by region?
   c. Do you provide the full method applied to each category of rating for each asset class (e.g. RMBS, CDO, etc.) separately by region?
   d. Is all of the above information freely accessible or is part of it only available for subscribers?

2. **Publication of changes in methodologies and assumptions:** Are all changes/adjustments to your methodologies and assumptions **published** and, if yes, where exactly are they published?
   a. Is there a special section on your website where changes made to criteria can be reviewed over time?
   b. Do you publish reports that discuss the changes made to criteria?
   c. Do you have press conferences to announce and explain those changes?

3. Do you provide links/references to those publications mentioned in question 2 in the respective rating change reports (i.e. the announcement of a change would let the reader know where to find the related methodology)?

4. If changes have been made to your methodology for a particular product type (say US sub-prime RMBS) but previous issues have not been reviewed against this methodology how do you ensure this is clear to the marketplace? If the previous issues were being reviewed how would this be made public?

5. Is publishing the methods you use enough to meet the requirements of the IOSCO Code and ensure sufficient transparency or do you see further possibilities for **improving transparency/the understanding** of
   a. your ratings?
   b. your rating process?

6. What steps does your firm take, if any, to contribute to enhancing the financial education of investors or potential investors?

7. Do you take steps to clarify any limitations to your ratings, including what they are intended to cover, or the methodologies and the assumptions underpinning them? How do you do this?

8. Do you publish, and if so, where, your approach to the **use of confidential information** in rating of structured finance (SF) operations? Does it differ from that which you follow in "traditional" corporate rating?

9. Do you consult with industry as to what disclosure levels they would like to see for methodology and model assumptions?

Human Resources

10. Please provide us with the following information with regard to SF ratings and traditional ratings:
    a. Exhibit 4, 8 and 13 of your NRSRO application form.
    b. The internal definition of the existing classes/levels of employees in the CRA's rating business: e.g. junior/mid/senior analysts, supervisors, committee analysts, lead analysts, etc? [1]
    c. Historical data for exhibit 8 (information on number of analysts/supervisors) covering the 1997-2006 period split by:
        I. the staff levels identified in point (b) above.
        II. Worldwide, EU and US based.
    d. What are the minimal educational and professional requirements for the different levels of employees (as defined in b) within the analytical staff, and have these requirements varied over the past 10 years? If they varied, how did they vary?
    e. The typical minimum number of years of experience according to levels of employees as defined in (b). Has this number evolved over the past 10 years? If so, how?

11. Please provide us with figures on the annual turnover of employees over the period 1997-2006, split per level (as defined in (1.b)), covering I) SF ratings and II) traditional ratings.

12. What are the risks presented by staff turnover to your ability to function effectively as a provider of accurate ratings and what steps do you take to mitigate these risks? Are these successful?

13. Has it become harder to fill vacancies in structured finance ratings teams over the last 5 years? If yes, what has been done to ensure you continue to have sufficient resource and to ensure this does not affect the quality of your ratings?

14. Typically, what is the composition of a monitoring/rating team in terms the job profiles and job levels and does this differ from teams that monitor/rate corporate bonds?

15. Please provide us with information on the average number of deals and average number of transactions under surveillance per lead analyst by type of SF products in the following table format:

Type of product	Average number of deals per lead analyst in 2006 (primary rating) *	Average number of transactions under surveillance per lead analyst in 2006
RMBS		
CMBS		
CDO		
ABS		
(additional if necessary)…		
…		

* both deals that resulted in a final rating and deals that did not result in a final rating.

16. What are the total annual wage costs in structured finance rating over the period 1997-2006?

17. Do you outsource part of the rating/surveillance process (e.g. data gathering, processing, modelling, etc.)? If yes:
    a. Please describe in which part(s) of the rating/surveillance process you make use of outsourcing and to what extent.
    b. What are the risks implied by such outsourcing and how do you tackle these?

[1] This question is designed to enable the CRA to answer the other questions based on its **own** human resources structuring method as different CRAs may have different human resources structures or seniority definitions (junior/senior, analyst/supervisor…).

c. Do you consider the (economic) gains of such outsourcing to exceed the risks? Please motivate.

Monitoring of transactions

18. What drives the frequency of rating review for structured finance? Why is this frequency appropriate? Please outline the process that would lead to a rating being taken to review committee?

19. Would regular reviews and announcements on the appropriateness of structured finance ratings - possibly based on some contractual deadlines (i.e. on a regular (quarterly/semi-annual basis) - help in preventing mass downgrades, improve the appropriateness of existing ratings? If not, why?

20. What changes have you made in terms of the surveillance of ratings since the widespread RMBS and CDO downgrades earlier this year?

21. How is the appropriate portfolio size determined for structured finance monitoring analysts? Are there any internal procedures which dictate how many transactions a monitoring analyst should be responsible for?

22. Are the costs of monitoring structured finance transactions fully covered by the fees charged specifically for monitoring when the rating agreement is initially made? What are the main incentives for maintaining effective monitoring of ratings?

23. How is committee time dedicated to rating reviews versus that dedicated to new ratings determined, particularly for structured finance? Are there clear internal procedures on how committee time is prioritised?

24. Are the committee members reviewing a rating the same as those who approved the initial rating? Are there any internal procedures dictating the composition of the review committee?

25. Is there a team of macroeconomic analysts within your firm responsible for systematically analyzing macro data coming in and building macroeconomic forecasts on which analysts can rely for their modelling/monitoring of ratings? If not, would this be useful?

26. Please provide us with a breakdown of revenues from SF ratings for initial rating/surveillance. How is the relative size of each of these parts of the fee decided?

Methodology changes

27. What prompts a review of rating methodology? Is there a central team that reviews methodologies or is it dependant on individual business lines self-evaluating their models?

28. Have you made any changes to how you evaluate the appropriateness of your methodologies on an on-going basis in light of the RMBS and CDO downgrades of earlier this year?

29. When the methodology for a type of structured finance product (example being US sub-prime mortgage backed securities) is amended:

    a. Do you automatically review all existing ratings against the new methodology and take rating action based on this review? If not, what is the rationale behind this?
    b. How is the scope of the application of the change of methodology determined? In other words on what basis does your firm decide whether or not to apply a change to existing ratings or just to new issuances?
    c. Please explain in detail how is the timing of rating action determined across all affected ratings?

30. Does your firm at any time make any overall review of the changes to methodologies made, for instance during one year, and their impact on ratings to assess trends for instance? Would this be made public?

31. Is there a risk of originators 'gaming the system' i.e. keeping requested data sets high whilst other valid indicators of asset quality decline? If yes, what mitigation have you put in place to reduce this risk?

32. Do you feel that your approach to the assessment of the quality of underlying asset data is appropriate? Are you considering any changes in this area (specially in light of the recent events in the US sub-prime mortgage market)?

Conflicts of Interest

33. When you rate a structured finance operation do you offer services such as impact assessment and/or models of evaluation or optimisation of the securitization structure? Can you quantify[2] the number of cases where these kinds of services were offered? Would these services be performed by the analyst who rates the final structure?

34. Is the analyst assigned to a certain structured finance rating deal allowed to give advice to the participants (before the rating is issued) about how to structure the deal in order to raise the rating? Is the analyst allowed to give feedback to the participants of a deal if the initial rating does not meet expectations? Are there limits to which elements of the deal can be addressed and to what extent (i.e. does the analyst provide suggested changes to the structure)? Is this covered in any internal policies? Is this interaction monitored by the agency?

35. Can factors such as greater complexity and/or innovative features in a structured finance deal lead to a higher than standard fee? If yes, please indicate how much these aspects can increase the initial level of the fees (as a percentage), how this increase is determined and who makes this decision.

36. Please provide us with data about your remuneration structures and those of your management hierarchy in your parent company.

Miscellaneous

37. Are you satisfied with the level of information received from servicers of European mortgage pools? Is this of a different quality, level of standardisation or frequency to information received in the US?

38. Are ratings across different asset classes similar in terms of pace and pattern of migration? Would some form of volatility indicator be possible, and appropriate for structured finance ratings?

[2] E.g. in percentage of total structured finance ratings issued, or by giving the indication "always", "often", "sometimes" or "never".