



# QUESTIONNAIRE REGARDING THE RATING OF STRUCTURED FINANCE INSTRUMENTS

## The ABI's Response to CESR/07-394

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### INTRODUCTION

The Association of British Insurers (the ABI) welcomes the opportunity to respond to CESR/07-394.

ABI members manage assets, on account of the business of their life and general insurance interests, of the order of £1,200bn (€1,800bn) as well as assets for third party clients. Amongst these assets are significant investments in structured finance with a particular focus on the Sterling fixed market. Our comments to the questions in Section B reflect this focus.

### B QUESTIONS ADDRESSED TO THE USERS OF RATINGS AND OTHER THIRD PARTIES

#### **Q1 Do you consider that access to and availability of structured finance ratings (and any subsequent changes) is satisfactory?**

By and large access is considered satisfactory to initial ratings. Although paid for by the issuer our members regard ratings as having the nature of a public good. Rapid and widespread dissemination is therefore essential. Obviously the same comment applies to any subsequent changes in ratings and the outcome of periodic reviews. Timeliness of material in these areas is not always as rapid as investors would desire.

#### **Q2 Are you satisfied with the CRAs disclosures on their fees policy?**

Our members recognise that, whilst CRAs may disclose their fees policy, structured finance is a complex area and each project is likely to be negotiated separately. Whilst there are issues of commercial confidence, the real area of interest to investors would be the correlation between size of fees and rating performance. Extremely complex projects may carry with them high levels of fees and possibly a higher probability of default.

Our members have indicated that whilst the ratings themselves and the methodology on which they are based are now better communicated by the CRAs, research on specific structures appears to be tightly limited to services paid for, at significant cost, by the investor or other interested parties.

**Q3     What are your views on the fact that the agencies use different analytical models to assess the portfolio credit risk? Are you satisfied with the way the rating agencies assess such risk?**

Overall our members see benefit from competition between different analytical models. They welcome the CRAs move towards the investor approach of recovery rather than the default approach traditionally adopted by the CRAs.

**Q4     Are you satisfied with the way the rating agencies assess the structural risks of the deals (i.e. legal risks, cash flow analysis, third parties' involvement in the transaction)?**

Our members recognise that structured finance is a rapidly-evolving field and that there is a strain on all parties in keeping up-to-date. CRA's background reports are welcome. That there are difficulties in this area is illustrated by the defaults of Eurotunnel and Metronet and their move into administration.

**Q5     Are you satisfied with the way the CRAs disclose their methodologies?**

Our members are encouraged by the improved disclosure of CRA methodologies. Nonetheless more disclosure on models and changes to them would be welcome.

**Q6     Are you satisfied with the frequency and quality of the information provided by the rating agencies to the market in connection with the monitoring of rated structured products (e.g. monitoring reports, special comments, etc)? Are you satisfied with the frequency and quality of information provided by the issuers/arrangers of structured transactions in order to monitor rated structured products?**

We detect some concern among our members as to the timeliness of periodic reviews particularly in the case of CDOs.

Our members consider that in the case of PPP and PFI projects there is a paucity of information on the relevant assets' performance post the initial ratings.

They support the efforts of the European Securitisation Forum, together with other industry participants, to improve disclosure.

**Q7     Are you satisfied with the CRAs disclosures on the reasons for a change in structured finance rating?**

Our members indicate that generally little detail is provided on the reasons for a change in a structured finance rating. Information is privileged and changes are largely taken on trust (see also the comment to Q6). Timeliness is a critical issue. Overall this area of disclosure is seen as one meriting some improvement.

**Q8 Are there any risks unique to rating structured finance compared to corporate credit rating?**

Structured finance is highly diverse. Our members did not indicate any 'unique' risks. Legal issues are considered more prominent than in general corporate rating

**Q9 Are you aware of any CRAs which provide ex post ancillary/advisory services? If so, do you perceive any potential conflicts of interest between the structured rating activity and any ex post ancillary/advisory services those CRAs may provide (i.e. pricing or valuation models)?**

Our members would expect all CRAs, as part of their own corporate governance, and in respect of the IOSCO Code requirements, to have appropriate policies for managing conflicts of interest.

**Q10 Is there a risk of conflicts of interest when a rating agency provides the rating of the provider of credit enhancement to structured finance products it has also rated?**

This is an example of the need for CRA conflicts of interest management policy. Our members have not indicated this as being an area of great concern.

**Q11 Are you satisfied with the way the agencies' communicate the measures they have adopted to manage those potential conflicts of interests?**

Yes, for those who have adopted the IOSCO Code.

**Q12 Do you think those measures are effective?**

It is an area which needs to be kept under continuous review.

**Q13 Is there sufficient resource and experience at the rating agencies to deal effectively with the demand for structured finance ratings?**

There is intense competition within the financial services sector overall for appropriately qualified personnel. The CRAs will not be immune from this pressure and will require appropriate recruitment and training policies to cater for the situation, which could be expected to demonstrate some cyclical attributes. Our members are concerned that CRAs are sufficiently resourced to provide consistent quality in their services.

**Q14 Does the current IOSCO Code of Conduct for CRAs deal appropriately with the risks in the rating of structured finance?**

The framework provided by the IOSCO Code is relatively recent and not specifically drafted for structured finance. A period of review seems appropriate before any changes might be proposed.

**Q15 Are there any additional points you would like to raise, on the basis of your experience in the structured finance business?**

Our members have noted the inevitability of the tension between competition between CRAs and the common good of the investor base overall. Disclosure and high standards of corporate governance are seen as the keys to managing this tension.