

## CREDIT RATING AGENCIES

Given the role CRAs play in rating structured finance transactions as highlighted by recent turmoil in this market sector, the CRA Task Force proposes several recommendations for modifying the IOSCO CRA Code of Conduct. The CRA Task Force notes that the IOSCO CRA Code of Conduct provides a mechanism for a CRA to explain why a particular provision is not being complied with.

### *Quality and Integrity of the Rating Process*

The IOSCO CRA Code of Conduct section 1 should be modified such that:

1. A CRA should take steps that are designed to ensure that the decision-making process for reviewing and potentially downgrading a current rating of a structured finance product is conducted in an objective manner. This could include the use of separate analytical teams for determining initial ratings and for subsequent monitoring of structured finance products, or other suitable means. If separate teams are used, each team should have the requisite level of expertise and resources to perform their respective functions in a timely manner. Subsequent monitoring should incorporate subsequent experience obtained. Changes in ratings criteria and assumptions should be applied where appropriate to subsequent ratings.
2. CRAs establish and implement a rigorous and formal review function responsible for periodically reviewing the methodologies and models and significant changes to the methodologies and models it uses. Where feasible and appropriate for the size and scope of its credit rating services, this function should be independent of the business lines that are principally responsible for rating various classes of issuers and obligations.
3. CRAs should adopt reasonable measures so that the information it uses is of sufficient quality to support a credible rating. If the rating involves a type of financial product with limited historical data upon which to base a rating, the CRA should make clear, in a prominent place, the limitations of the rating.
4. CRAs should ensure that the CRA employees that make up their rating committees (where used) have appropriate knowledge and experience in developing a rating opinion for the relevant type of credit.
5. CRAs should establish a new products review function made up of one or more senior managers with appropriate experience to review the feasibility of providing a credit rating for a type of structure that is materially different from the structures the CRA currently rates.
6. CRAs should assess whether existing methodologies and models for determining credit ratings of structured products are appropriate when the risk characteristics of the assets underlying a structured product change materially. In cases where the complexity or structure of a new type of structured product or the lack of robust data about the assets underlying the structured product raise serious questions as to

whether the CRA can determine a credible credit rating for the security, the CRA should refrain from issuing a credit rating.

7. A CRA should prohibit CRA analysts from making proposals or recommendations regarding the design of structured finance products that the CRA rates.
8. CRAs should ensure that adequate resources are allocated to monitoring and updating its ratings.

#### *CRA Independence and Avoidance of Conflicts of Interest*

The IOSCO CRA Code of Conduct section 2 should be modified such that:

9. A CRA should establish policies and procedures for reviewing the past work of analysts that leave the employ of the CRA and join an issuer that the analyst has rated, or a financial firm with which an analyst has had significant dealings as an employee of the CRA.
10. A CRA should conduct formal and periodic reviews of remuneration policies and practices for CRA analysts to ensure that these policies and practices do not compromise the objectivity of the CRA's rating process.
11. A CRA should disclose whether any one issuer, originator, arranger, subscriber or other client and its affiliates make up more than 10 percent of the CRA's annual revenue.
12. To discourage "ratings shopping" by allowing for the development of alternative analyses of structured finance products, CRAs as an industry should encourage structured finance issuers and originators of structured finance products to publicly disclose all relevant information regarding these products so that investors and other CRAs can conduct their own analyses of structured finance products independently of the CRA contracted by the issuers and/or originators to provide a rating. CRAs should disclose in their rating announcements whether the issuer of a structured finance product has informed it that it is publicly disclosing all relevant information about the product being rated or if the information remains non-public.
13. A CRA should define what it considers and does not consider to be an ancillary business and why.

#### *CRA Responsibilities to the Investing Public and Issuers*

The IOSCO CRA Code of Conduct section 3 should be modified such that:

14. A CRA should assist investors in developing a greater understanding of what a credit rating is, and the limits to which credit ratings can be put to use vis-à-vis a particular type of financial product that the CRA rates. A CRA should clearly indicate the attributes and limitations of each credit opinion, and the limits to which it verifies information provided to it by the issuer or originator of a rated security.

15. A CRA should publish verifiable, quantifiable historical information about the performance of its rating opinions, organized and structured, and, where possible, standardized in such a way to assist investors in drawing performance comparisons between different CRAs.
16. Where a CRA rates a structured finance product, it should provide investors and/or subscribers (depending on the CRA's business model) with sufficient information about its loss and cash-flow analysis so that an investor allowed to invest in the product can understand the basis for the CRA's rating. A CRA should disclose the degree to which it analyzes how sensitive a rating of a structured financial product is to changes in the CRA's underlying rating assumptions.
17. A CRA should differentiate ratings of structured finance products from other ratings, preferably through different rating symbols. A CRA should clearly define a given rating symbol and apply it in the same manner for all types of products to which that symbol is assigned.
18. A CRA should disclose the principal methodology or methodology version in use in determining a rating.

*Disclosure of the Code of Conduct and Communication with Market Participants*

The IOSCO CRA Code of Conduct section 4 should be modified such that:

19. A CRA should publish in a prominent position on its home webpage links to (1) the CRA's code of conduct; (2) a description of the methodologies it uses; and (3) information about the CRA's historic performance data.