



International Organization of Securities Commissions
Organisation Internationale des Commissions de Valeurs
Organização Internacional das Comissões de Valores
Organización Internacional de Comisiones de Valores

15 April 2013

Ministers of Finance and
Central Bank Governors of the G20

Ref: 2013/GM/GS/G20/72

Re: Transparency and Competition Among Credit Rating Agencies

Dear Ministers and Central Bank Governors,

The International Organization of Securities Commissions (“IOSCO”) appreciates the invitation of the G20 Finance Ministers and Central Bank Governors (“G20”) to respond to the G20’s communiqué resulting from its meeting on November 4-5, 2012. Our response addresses the following statement in the communiqué: “We encourage further work to enhance transparency of and competition among credit rating agencies and ask IOSCO to provide a report on ongoing work at our meeting in April.”¹

IOSCO believes that transparency and competition of credit rating agencies (“CRA”) can promote *investor protection*; help ensure *fair and transparent markets*, and contribute to *reduction of systemic risk*, in line with IOSCO’s core objectives. As discussed below, IOSCO has been engaged in efforts to promote competition through increased transparency in the CRA industry for many years.²

¹ See G20, Communiqué of Ministers of Finance and Central Bank Governors of the G20, Mexico City (Nov. 4-5, 2012), available at <http://www.g20.org/load/780984360>.

² IOSCO has a committee on CRAs (the “Committee”). This Committee is made up of member jurisdictions that have established CRA registration and oversight programs at the national level (or regional level in the case of the European Union) and that have been engaged in CRA matters for many years through participation in IOSCO’s task force on CRAs (the predecessor to its committee on CRAs).

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Competition in the CRA Industry

The CRA industry has historically been dominated by three globally active CRAs – Fitch Ratings Ltd. (“Fitch”), Moody’s Investors Service, Inc. (“Moody’s”), and Standard & Poor’s Rating Services (“S&P”) based on the issuer pay model.³ In 2011, these three CRAs accounted for approximately 98% of the outstanding credit ratings by CRAs registered in the United States, including approximately 96% of asset-backed security ratings, 91% of corporate issuer ratings, and 99% of government security ratings.

Notwithstanding this market dominance, smaller independent CRAs operate in a number of IOSCO member jurisdictions. These smaller CRAs may focus on niche areas or on issuers not rated by the three largest CRAs. Others may operate under the subscriber-pay model, in which subscribers are required to pay to access the CRA’s database of credit ratings. Some of the smaller CRAs also directly compete with Fitch, Moody’s, and S&P.

The following table summarizes the total number of registered CRAs located in certain IOSCO member jurisdictions, as well as the number of such CRAs affiliated with Fitch, Moody’s, or S&P.⁴

IOSCO Member Jurisdiction	Number of Registered CRAs	Number of CRAs affiliated with Fitch, Moody’s, or S&P
Argentina	4	3
Australia	7	3
Brazil	6	3
Canada	4*	3
Chile	4**	2***
European Union	19	3
Hong Kong	7	3

³ See U.S. Securities and Exchange Commission, Annual Report on Nationally Recognized Statistical Rating Organizations 8 (Dec. 2012), available at <http://sec.gov/divisions/marketreg/ratingagency/nrsroannrep1212.pdf>.

⁴ Note, however, that the percentage of a jurisdiction’s CRAs affiliated with the three largest CRAs is not necessarily representative of the three largest CRAs’ market share. For example, although the three largest CRAs comprise 71% of Japan’s registered CRAs, they only have approximately 55% of Japanese CRAs’ market share, as measured by disclosed sales volume for credit rating services in 2011. Similarly, although the three largest CRAs comprise only 30% of the total CRAs registered in the United States, they reported approximately 97% of the total net income reported by all U.S. registered CRAs in 2011. See U.S. Securities and Exchange Commission, Annual Report on Nationally Recognized Statistical Rating Organizations 10 (Dec. 2012), available at <http://sec.gov/divisions/marketreg/ratingagency/nrsroannrep1212.pdf>.

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Japan	7	5
Korea	4	2
Mexico	5	3
Taiwan	2	2
Turkey	6	3
United States	10	3

*Includes DBRS Limited

** DBRS Limited is a partner in one of these CRAs

***A subsidiary of Fitch and a CRA strategically allied with S&P

IOSCO will *continue to monitor* the evolution and market concentration of rating markets on a continuous basis through its Committee on Credit Rating Agencies.

Link between transparency and competition

The success of smaller and new-entrant CRAs in competing with the three largest CRAs in large part depends on convincing investors that their credit ratings are of high quality, which, in turn, will incentivize issuers to hire them. This is where transparency can play an important role in market competition. Transparency allows investors to compare the practices of CRAs and allows smaller CRAs and new entrants to establish points of observable competitive difference from the three largest CRAs. In turn, this incentivizes larger CRAs to update their internal policies and procedures to improve the quality of their credit ratings and retain credibility among investors and other users of credit ratings. This is the competitive dynamic that the CRA transparency measures implemented by IOSCO and its members seek to foster.

Rating structured finance products is one area where increased transparency may have a modest positive impact on competition in the CRA industry. The poor performance of the three largest CRAs in rating structured finance products in the period leading up to the 2008 financial crisis is well known. Among the CRAs registered in the United States (which include the three largest CRAs), there has been a slight increase in U.S. market share for smaller CRAs in rating structured finance products since the financial crisis. Although the three largest CRAs continue to dominate the credit rating market, they reported a decline in their market share of structured finance ratings from approximately 96% in 2008 to approximately 91% in 2011. Most of this

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decrease is related to a lower market share for one of the three largest CRAs and a slight increase in the market share for three smaller CRAs.⁵

IOSCO acknowledges that other factors also affect competition in the credit rating industry. New entrants face significant barriers to entry, including high start-up costs and the difficulty in changing investor preference for ratings determined by the large established CRAs. In addition, laws, regulations, and private contracts referencing credit ratings sometimes only recognize ratings issued by larger or regulated CRAs. This embedded use of ratings in laws and regulations could be a possible factor contributing to lower competition among CRAs. IOSCO notes that the Financial Stability Board has issued principles to reduce public and private sector reliance on credit ratings.⁶ Some member jurisdictions also are taking steps to ensure that the use of ratings in regulation does not result in unnecessary barriers to entry and regulatory authorization for new CRAs. IOSCO supports these ongoing initiatives to reduce mechanistic reliance on ratings.

IOSCO Work to Date to Promote CRA Transparency

Transparency measures are a fundamental component of IOSCO's CRA standards. In September 2003, IOSCO published a set of principles with respect to CRAs (the "IOSCO CRA Principles").⁷ The IOSCO CRA Principles are intended to be a useful tool for CRAs, regulators, and others seeking to improve how CRAs operate and how credit ratings are used by market participants. The IOSCO CRA Principles address four key objectives that are designed to promote informed, independent analyses and opinions by CRAs. One of the objectives is: "Transparency and timeliness of ratings disclosure – CRAs should make disclosure and transparency an objective of their ratings activities."⁸

⁵ See *id.* at 10.

⁶ See Financial Stability Board, Principles for Reducing Reliance on CRA Ratings (Oct. 27, 2010), available at http://www.financialstabilityboard.org/publications/r_101027.pdf. See also Financial Stability Board, Roadmap and Workshop for Reducing Reliance on CRA Ratings (Nov. 5, 2012), available at http://www.financialstabilityboard.org/publications/r_121105b.pdf.

⁷ See IOSCO Technical Committee, Statement of Principles Regarding the Activities of Credit Rating Agencies (Sept. 2003), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD151.pdf>.

⁸ The transparency objective in the IOSCO CRA Principles has five subsections. These subsections provide, among other things, that CRAs should publish sufficient information about: (1) their procedures and methodologies so that outside parties can understand how a rating was determined by the CRA, and (2) historical default rates for the CRA's rating categories and whether the default rates of these categories have changed over time.

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In 2004, following the publication of the IOSCO CRA Principles, IOSCO published the Code of Conduct Fundamentals for CRAs (the “IOSCO CRA Code”), which provided more detailed guidance to CRAs on how to implement the IOSCO CRA Principles. The IOSCO CRA Code includes a section on transparency and timeliness of ratings disclosure.⁹ In addition, the IOSCO CRA Code serves as a benchmark for regulators when designing their CRA registration and oversight programs and supervising CRAs; while many regulators incorporate requirements from the Code into their domestic regulation, others make direct reference to the IOSCO CRA Code.

As conveyed in its open letter of November 12, 2008 to the G20,¹⁰ IOSCO took steps to address concerns about the role of CRAs in the wake of the financial crisis. In particular, IOSCO published a report examining the manner in which CRAs participated in the expansion of the structured finance markets.¹¹ In addition, the IOSCO CRA Code was revised to address concerns about certain CRA shortcomings.¹²

⁹ See IOSCO Technical Committee, Code of Conduct Fundamentals for Credit Rating Agencies (Dec. 2004), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD180.pdf>. With regard to transparency, the IOSCO CRA Code recommended that a CRA disclose the following information to the public: (1) the CRA’s policies for distributing ratings, reports, and updates; (2) when each rating was last updated; (3) ratings for publicly issued securities and issuers; (4) the key elements underlying each rating opinion; (5) the historical default rates of the CRA’s rating categories and whether the default rates for these categories changed over time; (6) for each rating, whether the issuer participated in the rating process; (7) any material modification to the CRA’s methodologies and significant practices, procedures, and processes; (8) a description on how the provisions of the CRA’s internal code of conduct fully implement the IOSCO CRA Principles and IOSCO CRA Code; (9) actual and potential conflicts of interest; and (10) the general nature of the CRA’s compensation arrangements with related entities. *Id.*

¹⁰ See Open letter from IOSCO to Chair of Financial Stability Forum, Minister of Finance, Brazil and Governor of Central Bank, Brazil (Nov. 12, 2008), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD282.pdf>.

¹¹ See IOSCO Technical Committee, The Role of Credit Rating Agencies in Structured Finance Markets (May 2008), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD270.pdf>.

¹² See IOSCO Technical Committee, Code of Conduct Fundamentals for Credit Rating Agencies (rev. May 2008), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf>. The revisions, among other things, added the following required disclosures to the IOSCO CRA Code: (1) whether any one issuer, originator, arranger, subscriber or other client and its affiliates make up 10% or more of the CRA’s annual revenue; (2) whether the issuer of a structured finance product has informed the CRA that it is publicly disclosing all relevant information about the rated product so investors and other CRAs can conduct their own analyses of these products independently of the contracted CRA; (3) the attributes and limitations of each credit opinion, and the limits to which the CRA verifies information provided to it by the issuer or originator of a rated security; (4) the degree to which the CRA analyzes how sensitive a structured finance product’s rating is to changes in the CRA’s underlying ratings assumptions; (5) the principal methodology or methodology version in use when determining a rating; and (6) publishing the CRA’s internal code of conduct on its home webpage. *Id.*

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In 2009, IOSCO published its review of whether CRAs have adopted a code of conduct and the degree to which CRAs' internal codes comply with provisions of the IOSCO CRA Code.¹³ IOSCO found that a large majority of the CRAs reviewed had substantially implemented the IOSCO CRA Code and/or its 2008 revisions, including the three largest CRAs.

In 2012, IOSCO published a survey report,¹⁴ which offers a comprehensive description of the key risk controls established by CRAs to promote the integrity of the credit rating process and the procedures established to manage conflicts of interest. The 2012 report serves as a resource to increase public understanding of the internal workings of CRAs, and to allow CRAs to compare their internal controls and procedures with those of their peers. The report, in conjunction with disclosures that CRAs make about their controls and procedures, also may help users of ratings draw their own conclusions about an individual CRA's controls and procedures and thereby help users make informed decisions with respect to their use of credit ratings.

Future IOSCO Work to Promote CRA Transparency

IOSCO is now in the process of revising the IOSCO CRA Code; as part of this process, the transparency provisions of the IOSCO CRA Code will be reviewed and enhanced as appropriate. The goal is to publish a draft of the revised IOSCO CRA Code for consultation in the first quarter of 2014 and the finalized IOSCO CRA Code in the summer of 2014. A tentative timeline for the project is set out below.

10-11 July 2013	Meeting of Committee on CRAs: Discussion of 1 st draft of revised IOSCO CRA Code
18-19 September 2013	IOSCO Board meeting
November 2013	Meeting of Committee on CRAs Discussion of 2 nd draft of revised IOSCO CRA Code

¹³ See IOSCO Technical Committee, A Review of Implementation of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies (Mar. 2009), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD286.pdf>.

¹⁴ See IOSCO Board, Credit Rating Agencies: Internal Controls Designed to Ensure the Integrity of the Credit Rating Process and Procedures to Manage Conflicts of Interest (Dec. 2012), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD398.pdf>.

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January 2014	Submission of finalized draft of the IOSCO CRA Code to the IOSCO Board for approval by written procedure
Early February 2014	IOSCO Board approval
Mid-February 2014	Publication of draft revised IOSCO CRA Code for consultation
Mid-February – Mid April	Consultation period
Mid-April – end of June / July 2014	Committee on CRAs: Review of consultation responses and finalization of revised IOSCO CRA Code Submission to the IOSCO Board for approval
July / August 2014	IOSCO Board approval and publication of revised IOSCO CRA Code

CRA Transparency Measures in IOSCO Member Jurisdictions

As a result of the global financial crisis, a strong consensus emerged that further regulatory intervention was needed with respect to CRAs. This consensus was encapsulated in the G20’s 2009 declaration on strengthening the financial system (the “G20 Declaration”), which stated, among other things, that all CRAs whose ratings are used for regulatory purposes should be subject to a regulatory oversight regime that includes registration and is consistent with the IOSCO CRA Code. The G20 Declaration further stated that IOSCO should coordinate full compliance between the IOSCO CRA Code and member jurisdictions’ regulatory regimes.¹⁵ In response to the G20 Declaration, CRA registration and oversight programs are now in effect in a number of IOSCO member jurisdictions.

In February 2011, IOSCO published a report that evaluated the regulatory implementation of the IOSCO CRA Principles in Australia, the European Union, Japan, Mexico, and the United States.¹⁶ Among other things, the report concluded that, while the structure and specific provisions of regulatory programs differ, the objectives of the IOSCO CRA Principles, including the transparency objective, are embedded in each of the programs reviewed. The report found

¹⁵ G20, Global Plan Annex: Declaration on Strengthening the Financial System (Apr. 2, 2009), available at <http://www.g20.utoronto.ca/2009/2009ifi.pdf>.

¹⁶ See IOSCO Technical Committee, Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies (Feb. 2011), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD346.pdf>.

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that this objective is given effect in regulatory programs through, for example, provisions that require a CRA to publicly disclose information about the methodologies it uses to determine credit ratings and statistics about the performance of its credit ratings.¹⁷ Since that report, several other IOSCO member jurisdictions have implemented CRA registration and oversight programs in line with the IOSCO CRA Principles.¹⁸ (See Appendix A.)

Based on the lessons learned from the recent financial crisis and subsequent changes in the regulatory environment, IOSCO published in 2010 an update of its Objectives and Principles of Securities Regulation (the “IOSCO Securities Regulation Principles”), which set the standards that the International Monetary Fund and World Bank use to assess the performance of a jurisdiction’s securities sector. One of these principles (Principle 22) focuses on the supervision of CRAs, and recommends that supervisors “ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.”¹⁹

We hope that the information set forth above provides a helpful summary of the efforts of IOSCO and its member jurisdictions to increase CRA transparency, and thereby, to promote competition among CRAs in a positive way. Please do not hesitate to contact us if we can be of further assistance.

Yours sincerely,

Greg Medcraft

Chairman of the Board
International Organization of Securities Commissions

Cc: Mr. Mark Carney, Chairman, Financial Stability Board
Mr. Svein Andresen, Secretary General, Financial Stability Board

¹⁷ See *id.*

¹⁸ In addition, the European Union and the United States conduct in-person examinations of their registered CRAs and to promote transparency, publish an annual report summarizing the key findings of these examinations.

¹⁹ See IOSCO, Objectives and Principles of Securities Regulation (June 2010), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf>.

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Appendix A

IOSCO Member CRA Transparency Provisions

These descriptions are intended to be illustrative of CRA transparency provisions in a given jurisdiction's laws and/or regulations. They are not intended to be a comprehensive description of all such provisions.

In Argentina, CRAs are required to disclose through the Argentinian Comisión Nacional de Valores' ("CNV") website a description of their methodologies to determine credit ratings, internal procedures for managing conflicts of interest, and information about the number and qualifications of credit analysts and their supervisors. CRAs are also required to disclose on a biannual basis the CRA's performance measurement statistics for their credit ratings. In addition, the Argentinian National Congress enacted a new capital markets law in November 2012, under which the CNV will issue a new CRA regulation that is scheduled to become operative by the second half of 2013.

In Australia, each licensed CRA must publish 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 (including historic default rates and performance of rating opinions). Licensed CRAs must also disclose to the public material modifications to methodologies, actual and potential conflicts of interest, and the general nature of compensation arrangements with rated entities. CRAs must provide Australia's Securities and Investments Commission with additional disclosures during the licensure process, in annual financial statements, in an annual compliance report, and any time there is an actual or likely significant breach of financial services laws.

In Brazil, registered CRAs are required to annually file a Reference Form for posting on the Brazilian Comissão de Valores Mobiliários' website, which discloses the CRA's performance measurement statistics for credit ratings since 2002, a description of the methodologies used to determine credit ratings, a description of the CRA's internal control policies and other policies to manage and identify conflicts of interest, and information about the number and qualifications of credit analysts and other employees.

In Canada, registered CRAs are required to publicly disclose their rating categories' historical default rates, the principal methodology used for each rating, and their methodologies and key rating assumptions, and any material modifications thereto. In addition, registered CRAs are

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required to annually file Form 25-101F1, which includes a detailed description of the CRA's methodologies, written policies and procedures regarding conflicts of interest and the misuse of material nonpublic information, internal controls to ensure the quality of rating activities, and information about the number and qualifications of credit analysts and their supervisors.

In Chile, registered CRAs are required to prepare an Annual Management Report, which includes comparisons with the previous year's rating actions as well as the CRA's administrative structure. In addition, registered CRAs must declare semi-annually that they do not have conflicts of interest with the issuers of securities rated by the CRA.

In the European Union, a registered CRA must make available in a central repository historical performance data (transition frequency and information about credit ratings issued in the past and their changes) and must publicly disclose its methodologies and descriptions of models and key assumptions and material changes thereto. With regard to conflicts of interest, a registered CRA must publicly disclose actual or potential conflicts that may influence the CRA's judgment, rated entities or related third parties from which it receives more than 5% of annual revenue, and the *contribution* of the largest twenty clients to the CRA's growth along with the rating(s) issued to such clients. CRAs also are required to annually publish a transparency report including information on the CRA's legal structure and ownership, internal control mechanisms, the outcome of the annual internal review of its compliance function and analyst rotation policy.

In Hong Kong, a licensed CRA must disclose its ratings transition frequency, recordkeeping policy, rating analyst rotation policy, internal control mechanisms, and Code of Conduct and changes thereto. In addition, licensed CRAs are required to publish historical default rates for their rating categories.

In Japan, registered CRAs must prepare Explanatory Documents for each fiscal year and make them available to the public. These documents must include, among other things, the CRA's sales volume, changes in ratings, historical default rates, safeguards against conflicts of interest, policies on confidentiality, and compliance policies. Registered CRAs are also required to disclose to the public the description of their rating policies and rating methodologies.

In Korea, a licensed CRA must make publicly available its credit rating performance report, which includes descriptions of the CRA's future outlook, principal redemption rate of rated securities, changes in ratings, historical default rates, and limits and characteristics of credit ratings. In addition, licensed CRAs must publicly disclose material modifications to rating methodologies and key rating-related policies including the CRA's Code of Conduct and fee schedule.

In Mexico, each registered CRA is required to disclose on its website historical information regarding the payment default rates for each of its rating categories, criteria for evaluating credit quality, and its Code of Conduct and policies for disclosure of ratings. In addition, CRAs are required to prepare an Annual Report disclosing statistical information about the performance of

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awarded ratings, information about their legal structure, internal control system, processes related to compliance, and rotation policy. Methodologies used to award or modify a rating must be disclosed through press releases.

In Taiwan, each licensed CRA must provide on its website the CRA's business report, which identifies the CRA's issued ratings during the year, information regarding default rates for each rating category, and credit rating methodologies and assumptions, as well as the CRA's organizational structure and financial condition. CRAs are also required to immediately publicly announce any changes in credit ratings, methodologies, and/or key rating assumptions. In addition to the public disclosure requirements, CRAs are required to disclose to Taiwan's Financial Supervisory Commission their internal control systems and audit plans, corporate bylaws, and financial statements.

In Turkey, each listed CRA must make publicly available its ratings, changes to ratings, historical default rates and changes thereto, rating methodologies, assumptions, and conflicts of interest that may affect agency decisions. Listed CRAs must also establish a publicly available Code of Conduct and establish a department to consider received complaints.

In the United States, registered CRAs are required to annually file and publicly disclose Form NRSRO, which includes the CRA's performance measurement statistics for its credit ratings (*i.e.*, default and transition rates), a description of the methodologies used to determine credit ratings, a description of the CRA's conflicts of interest (*e.g.*, being paid by issuers to rate their securities), written procedures to manage conflicts of interest, and information about the number and qualifications of credit analysts and their supervisors. CRAs also are required to disclose on their websites histories for their ratings.

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