



Mr. Tim Pinkowski

International Organization of Securities Commissions (IOSCO)
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Reference: Code of Conduct Fundamentals for Credit Rating Agencies – Consultation report 01/2014 dated February 14th, 2014

Dear Mr. Pinkowski,

Reference to the publication of the above consultation, we are pleased to hereby submit the views of our association, which represents 8 ESMA registered CRAs and 4 agencies registered or recognized according to national legislation in Russia, Switzerland and Turkey.

The objective of the revision is to align the IOSCO Code with the specific legislation on CRAs being adopted in several jurisdictions, so that the “CRA Code works in harmony with these legislations”. Whereas the current version of the CRA Code dates back to 2008, substantial legislation on Credit Rating Agencies has been adopted in the Europe Union and several other jurisdictions. While we welcome that the new code introduces some definitions, we request clarifications on some terms and propose also some extensions. As the CRA Code is being substantially extended to cover many of the provisions applicable in Europe, we nonetheless note that the IOSCO CRA Code contains additional requirements beyond EU requirements (see section 2).

Given the spill-over of new requirements from national legislation into the international CRA Code, changes to the CRA Code will impact more heavily on CRAs based in jurisdictions without specific legislation on CRAs. In our last section, we welcome that the CRA Code takes into account the variety of business models and propose that the CRA Code should also reflect the size of the CRA and the impact of its ratings on the financial market and financial stability. In order to enhance competition in the rating market, adherence to the CRA Code should be followed by certain benefits for the complying CRAs.

Clarifications/Additions

We welcome that the CRA Code includes going forward a glossary of key terms. With respect two proposed definitions, we would appreciate understanding the background for some of your choices:

- “Credit rating means an assessment regarding the creditworthiness of an entity or obligation (..).” The EU Regulation defines a credit rating in Art 3 (1) a as “an opinion regarding the creditworthiness of an entity (...)”. While the recently amended Regulation in Europe introduced a civil liability regime for CRAs, the definition of “credit rating” as an opinion remained unchanged. We therefore propose that the IOSCO code is being aligned with the text of the EU Regulation.

- The definition of “entity” in your code is highly general – we assume that the intention is to refer to “rated entity”
- The code also refers regularly to “underwriter” and “arranger” without specifying the terms. As the Code imposes requirements on CRAs vis-à-vis those “persons”, kindly clarify the terms and elaborate how the issuance of credit ratings by a CRA could be affected by these.

With respect requirement 1.1 on rating methodologies, we propose including an additional element: “rating methodologies should reflect the size and complexity of the rated entity”. This requirement ensures that the degree of sophistication of the methodologies is adapted to sizes of the rated entities. Such a proportionality requirement in the methodologies would mean more detailed approaches for complex structures and, simultaneously, could lead to a wider coverage of SMEs and an improved access to finance.

Requirement 2.6 (d) relates to conflicts of interests arising from “being part of a pool of CRAs that each provide a preliminary indication of a credit rating to an entity”. From a practical perspective, in most cases, the CRAs will not be informed whether other agencies have been engaged to provide such preliminary ratings or not.

Requirement 3.1 states that “A CRA that is subject to a CRA registration and oversight program administered by a regional or national authority should not state or imply that the authority endorses its credit ratings or use its registration status to advertise the quality of its credit ratings”. A similar requirement can be found in the EU regulation on Credit Rating Agencies. Given that CRAs may have activities outside of the scope of the applicable legislation on CRA, we propose that CRAs should clarify to which activities/products their registration status relates.

The requirement in 3.8 can be interpreted differently: a) the CRA must disclose its methodology (ies); b) each rating report must specify according to which version of the methodology it has been issued etc. We therefore would welcome a clarification.

With respect to requirement 3.12 we kindly ask you to clarify whether it relates to “an issuer / a rated entity having participated in the rating process” or “to an issuer / a rated entity having initiated the rating process”. In some cases, issuers / rated entities participate voluntarily in the rating process solicited by another party (eg user of ratings), while not having requested or paid for the rating – the difference between the two is therefore important.

CRA Code requirements going beyond the EU framework on CRAs

In 2.5, the CRA Code requires that the credit rating business should be “operationally, legally, and, if practicable, physically separate[d]” from any other business of the CRA. The EU Regulation on CRAs does not require the legal separation of the different activities but requires that CRAs manage potential conflict of interests by adopting sound processes.

The CRA Code specifies in 2.8 (a) the following:” When the CRA receives from a rated entity, obligor, underwriter, or arranger compensation unrelated to its credit rating services, the CRA should disclose such unrelated fees as a percentage of total fees received from the rated entity, obligor, underwriter, or arranger in the relevant credit rating report or elsewhere, as appropriate.” While ESMA registered CRAs need to : a) disclose the share of revenues generated from ancillary services and other activities, this requirement does not apply at the level of the rated entity and b) disclose in the final ratings reports any ancillary services provided for the rated entity or any related third party (Annex 1, Section B – Art 4) but not the percentage represented by ancillary businesses.

With respect the requirement in 3.9, please note that the timing when the CRA has to inform the issuer / rated entity differs between the EU Regulation and the IOSCO Code. While the

IOSCO Code mandates this “prior to taking a credit rating action”, the EU Regulation requires in Section D I 3 of Annex I that the rated entity is being informed after the rating action but prior to general disclosures.

In 4.2 the CRA Code establishes a “risk management position (...) responsible for identifying, assessing, monitoring, and reporting the risks arising from its activities, including, but not limited to legal risk, reputational risk, operational risk, and strategic risk. While in the EU “a credit rating agency shall have sound administrative and accounting procedures, internal control mechanisms, *effective procedures for risk assessment*, and effective control and safeguard arrangements for information processing systems, such a separate function is not foreseen in the EU Regulation.

The CRA Code requires in 4.3 that “employees undergo formal ongoing training at reasonably regular time intervals”. The EU regulation on CRAs does not require such specific training programs but rather targets that “rating analysts (...) have appropriate knowledge and experience for the duties assigned” (Article 7.1). The EU has therefore retained objectives while the CRA Code codifies some means and measures.

The CRA Code introduces in 5.3 a new function in charge of communication with “market participants and the public”. While the objective is understandable, the EU Regulation does not require such a function, which may be difficult and costly for small CRAs to implement.

Business models, size of agencies and impact on competition

The proposed CRA Code acknowledges that there is a wide variety of business models of CRAs¹ and that CRAs have very different sizes. The CRA Code explicitly mentions at several occasions that the requirement depends “on the CRA’s business model”, which is much appreciated.

While the requirement in 3.9 (to inform the issuer / rated entity of the rating before general publication) uses the term “where feasible and appropriate”, we propose adding here

¹ Beyond the pure issuer-pays model and the pure investor-pays model there are several other business models in operation and there is also the potential for further models to be developed:

- Pure issuers-pays model: issuer pays the rating agency for assigning the rating. The rating could be disclosed publicly and research reports (rating reports) are freely available on the website of the CRA.
- Issuer-pays with investor-pays components: the issuer pays the rating agency for assigning the rating. The rating may be publicly available at the issuer’s website, information at the CRAs website requiring a paid access (to read reports and ratings)
- Mixed model: in this case, the CRAs generates approximately the same share of revenues from issuers and users. The CRA usually charges issuers for the rating (but may also do an unsolicited ratings if required to provide users the expected coverage) and charges users for access to ratings/reports.
- Investor-pays model: the CRA generate its revenues exclusively from users of ratings and does not receive fees from rated entities. While public, Ratings are not in the public domain. Users may buy single reports or have a subscription.
- Special model: a CRA may have a framework agreement with an entity representing several issuers to rate all their members.

These business models need to be complemented by the market segment coverage and geographic coverage of CRAs. Furthermore, CRAs may have (substantial) additional activities in rating related fields (eg credit scoring, fund ratings, asset management rating, corporate governance assessments).

“depending on the CRA’s business model”. While this requirement is a standard element in the rating process of issuer-pays agencies, this requirement goes against the business model of CRAs issuing “pure” investors solicited ratings using only public information (eg from stock-listed companies) and substantially increases the costs to these CRAs.

While the CRA Code is intended to be independent of the size of agencies, certain provision impact differently on smaller agencies:

- Requirement 2.8 (b) states that CRA should disclose the clients, who contribute more than 10% to their revenues. For small, very specialized CRAs, the threshold of 10% may be reached easily while larger players will not be affected. We therefore think that small CRAs should not be required to provide this information publicly.
- The CRA Code includes substantial requirements on the rating process and the organization of a CRA. Implementing all the provisions² would result in a high staffing number and a high administrative burden, which can only be supported by very large organizations.

On page A-3, you mention that the measures described in the CRA Code are not “designed to be used only by CRAs with large staffs and compliance functions” and that “the types of mechanisms and procedures CRAs adopt to ensure that the provisions of the IOSCO CRA Code are followed will vary according to the market and legal circumstances in which the CRA operates”. We think that this provision should be extended to include also “the size of the CRA as well as the potential impact of the CRA ratings on financial market participants and financial stability”.

Smaller, highly focused CRAs have usually a lower reach out than the larger players and do not impact on financial stability. Smaller CRAs should have some flexibility towards the very comprehensive requirements as set out in the CRA Code: disclosing the number of provisions where the small CRA is not fully compliant could lead users of ratings to believe that the ratings issued are of lower quality. Instead of describing where CRAs are deviating from the CRA Code, we rather recommend that CRAs should describe their business model and how potential conflicts of interests are addressed in order to ensure that the ratings are objective, independent and of the highest quality.

The EU Regulation foresees in Article 6 (3) some exemptions for smaller CRAs (having less than 50 employees). Such exemptions can be granted by ESMA if the CRA demonstrates that the exemptions are proportionate to “the nature, scale and complexity of its business and the nature and range of issue of credit ratings (...)”. We submit to your kind evaluation whether the IOSCO Code could be complemented by a similar provision.

While the revised IOSCO CRA Code increases the requirements on CRAs, the CRA Code does neither address the rating market structure nor how ratings are being used. In your letter to the G20 dated April 15th, 2013 you mention that the rating market is heavily concentrated and that “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

² The CRA Code mentions the following functions: internal audit, communication with market participants, risk management function, compliance function, review function; rating analyst, monitoring of ratings, board, sales

embedded use of ratings in laws and regulations could be a possible factor contributing to lower competition among CRAs³.

The extension of the CRA Code increases the organizational requirements on CRAs (and thereby increases the start-up and running costs) and reduces competition in the market. In countries without specific legislation on CRAs, in order to make adherence with the CRA Code attractive, references in national laws and regulations should equally apply to these agencies and should not be restricted to a small number of very large agencies.

On an international level, the CRA Code could be used as an international benchmark. Countries having adopted specific legislation on CRAs would be assessed against the CRA Code – if these legal regimes correspond to the CRA Code, CRAs originating from these countries would qualify as “international CRAs” and could become recognized in countries without specific legislation on CRAs.

We thank you for your attention and remain at your full disposal for any clarifications or if we can be of any further assistance to you.

Sincerely yours

Thomas Missong
EACRA President

Thomas Morgenstern
EACRA Secretary General

About EACRA

The European Association of Credit Rating Agencies (“EACRA”), registered in Paris, was established in November 2009. The Members of the Association currently originate from 10 European countries and include the following companies:

A.M. Best Europe - Rating services Limited (AMBERS) is a subsidiary of A.M. Best Inc who have been providing ratings to the Insurance Sector since 1899. AMBERS' rating coverage includes regional, national and global insurers located throughout Europe, the Middle East and Africa.

Assekurata Assekuranz Rating-Agentur is the first independent German rating agency that has specialized on the quality evaluation of insurance companies

Axesor: The first Spanish Rating agency registered with ESMA. Specialized in the middle market segment, with ample coverage of the Spanish corporate market.

Capital Intelligence (CI) offers independent rating opinions on financial institutions, corporates and governments in a wide range of countries, especially the emerging markets of Asia, Europe and the Middle East.

Cerved Group: Italian Credit Rating Agency recognized ECAI by Bank of Italy

Creditreform Rating: based in Germany, a company of the Creditreform Group that is European market leader in the sector of business information was founded 2000 and is specialised in ratings of companies, bonds, funds and structured finance products across

³ Available at the IOSCO website under: http://www.iosco.org/library/briefing_notes/pdf/IOSCOBN01-13.pdf

Europe..

CRIF: International Credit Rating Agency based in Italy providing both solicited and unsolicited Corporate ratings.

Ellisphere: French leader in business & marketing information and credit management solutions, providing a large range of tools and solutions to secure companies' supply chain financing and improve their development.

Fedafin AG : is registered with the Swiss Financial Markets Authority and acts as rating provider to the Swiss stock exchange

Informa D&B is the Marketing, Financial and Business Information leading company in Spain, offering currently more than 3.7 million online ratings on Spanish companies

Informa is the Marketing, Financial and Business Information leading company in Portugal, offering currently more than 820K online ratings on Portuguese companies

JCR Eurasia is an international credit rating institution based in Turkey.

National Rating Agency (NRA) is one of the leading independent rating agencies in Russia. As of today National Rating Agency has assigned ratings to over 750 leading Russian and international companies.

RusRating is a credit rating agency based in Moscow, with sister agencies in Armenia and Kazakhstan. It is accredited with the Ministry of Finance of the Russian Federation.

Scope was founded as an independent rating agency in Berlin, Germany, in 2002. The company is specialized in ratings and analysis of SMEs, bonds, certificates and funds across Europe.

The Members of the Association have very different business models while assigning ratings. All are deeply rooted in their respective markets; enjoy a high market share and a good reputation with local investors