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PRESS RELEASE

CESR advises the European Commission to take steps and offers its proposal to enhance the integrity and quality of the rating process

CESR publishes today its report entitled “*CESR’s Second report to the European Commission on the compliance of credit rating agencies with the IOSCO Code. The role of credit rating agencies in structured finance*” (Ref. CESR/08-277).

Following the European Commission’s additional request for CESR to review several aspects of the rating process regarding structured finance instruments (Ref.CESR/07-608), and after analysing the responses from market participants to CESR’s Consultation Paper (Ref.CESR/08-036), CESR is now publishing its final report to the European Commission including CESR’s policy proposal in relation to Credit Rating Agencies (CRAs).

Ingrid Bonde, the Chair of the CESR task force on CRA, said: “*The events of last year surely merit a thorough re-evaluation of the current self-regulatory regime. The public debate has made evident that CRAs perform an important role and are a key element in the structured finance market as it is currently organised. Therefore, although CRAs’ ratings are legally no more than opinions, there is a clear public interest aspect to the information the CRAs provide. This leads CESR to believe that there is a strong need to take a step forward in ensuring integrity and confidence in the rating industry and encouraging the effective use of ratings by investors*”.

The report includes, in Section V, **CESR’s proposals to enhance the integrity and quality of the rating process:**

1. CESR urges the Commission as an immediate step to form an international CRAs standard setting and monitoring body to develop and monitor compliance with international standards in line with the steps taken by IOSCO, using full public transparency and acting in a 'name and shame' capacity to enforce compliance with these standards via market discipline. This body should be formed of senior representatives of the investor, issuer and investment firms’ communities and have an international nature. In addition, CRAs should also be part of the body when acting in its standard setting capacity but not when performing its monitoring activity. The members of the body would be appointed in the majority by the international regulatory community and would be accountable to those that appoint them.
2. If international regulatory involvement cannot be achieved in the short term, CESR recommends that this body is formed at an EU level. CESR sees itself in a good position to play a key role in the process of regularly assessing whether the body is fulfilling its objectives. To this effect the body should report periodically.
3. In the absence of support from market participants or failure of the body to meet the objectives of ensuring the integrity and transparency of ratings, CESR considers that this initiative would not add value and that the supervisory authorities should step in to ensure, probably through regulation, the integrity and quality of the rating process.

The report emphasizes that this proposal (either with an international dimension or with a European one) should be implemented within a short time period. To that end, CESR encourages the European Commission to prepare a calendar setting deadlines for the different steps to be followed and considers that unjustifiable lack of progress according to the timetable should lead the Commission to shift to the consideration of supervisory oversight structures (step 3).



Besides the policy proposal, the report includes an introductory part and the following three additional sections.

Section II contains a **summary of the main initiatives in the international market in relation to the role of CRAs in the structured finance sector.**

Section III includes some **recommendations** (summarised below) in relation to the main areas analysed by CESR:

- **Transparency:** CESR highlights the need for CRAs to take appropriate action on an ongoing basis to ensure that they communicate clearly regarding the characteristics and limitation of the ratings of structured finance products. CESR also believes further information should be provided on critical model assumptions to facilitate a greater understanding by market participants and that ratings should clearly label which methodology and version has been used. Where possible, CESR advocates that this information and information on rating performance should be provided in a standardised, publicly available format to support market participants in reaching their investment decisions.
- **Human Resources:** CESR urges CRAs to effectively resource themselves to ensure their ratings are, and remain, of a sufficient quality. CESR expects that CRAs improve the disclosure of selective human resources indicators to promote confidence that they are appropriately resourced and to ensure that remuneration structures are appropriate to promote independence and avoid conflicts of interest in the rating process.
- **Monitoring of Ratings:** CESR stresses the need for CRAs to effectively resource themselves to ensure that their monitoring remains effective and that rating action is taken in a timely manner.
- **Conflicts of Interest:** CESR acknowledges that a clearer international consensus over acceptable interaction between CRAs and issuers, what constitutes advisory practice and a definition of what constitutes ancillary business would be of benefit to the market. CESR also stresses the need for CRAs to be transparent in the disclosure of the fees they receive from issuers.

Section IV of the report provides an **analysis of the changes in the CRA's codes of conduct.** It builds on the work included in CESR's first report to the European Commission and contains, in a columnar format, an analysis of the changes on those provisions of the CRAs' codes that CESR identified last year as areas of non-compliance with the IOSCO Code. The conclusion of this analysis has been that, as already mentioned in CESR's first report, the four CRAs' codes comply to a large extent with the IOSCO Code. Some CRAs have implemented a couple of improvements in their respective code of conduct, but there are still areas or provisions where the CRAs' codes could be improved. Although there have been some changes introduced, CESR expected to see a more rigorous approach from CRAs in response to last year's report and, thus, CESR's expectations for improvement have been only partially met by the CRAs.

The source of information that CESR has used for the preparation of this report is the input received from the CRAs in meetings and responses to questionnaires and from market participants through the consultation processes undertaken. In addition, CESR has taken into account the main initiatives that are being undertaken by securities regulators and other governmental bodies to assess how markets and regulators have reacted to the structured finance market turmoil (described in section II of the report). As some of these initiatives are now underway but have not been finalised yet, CESR has not been able to factor into this report any conclusions made in these fora.

While preparing the report, CESR has worked in close co-operation with CEBS (that has participated as an observer to the task force), the SEC (that has invited CESR secretariat to the SEC to get first hand information on the application of the new US legislation and has attended some of the task force meetings as observers) and with IOSCO.



Notes for editors

1. Following a request by the European Commission for CESR to assess the treatment of Credit Rating Agencies (CRAs), CESR proposed a voluntary framework to monitor the application of the IOSCO Code by CRAs which was launched in December 2005.
2. Subsequently, the European Commission published a Communication on 9 January 2006, where it expressed its intention to request CESR to report, on an annual basis, on the assessment of CRAs compliance of the IOSCO Code of conduct.
3. Moody's, Standard and Poors', Fitch Ratings and DBRS Limited are the CRAs that have currently chosen to adhere to the voluntary framework.
4. In summary, this framework includes three elements: (i) an annual letter from each CRA to be sent to CESR, and made public, outlining how it had complied with the IOSCO Code and indicating any deviations from the Code; (ii) an annual meeting between CESR and the CRAs to discuss any issues related to implementation of the IOSCO Code; and (iii) CRAs would provide an explanation to the national CESR member where any substantial incident occur with a particular issuer in its market.
5. Following the Commission's first request in June 2006, CESR provided in its first report (Ref. CESR/06-545) published on 4 January an analysis of the codes of the four CRAs that have chosen to adhere to the voluntary framework in relation to the IOSCO Code.
6. In CESR's progress report of 15 May 2007 (Ref. CESR/07-304), CESR indicated that as part of its regular review it would look particularly into the areas of non-compliance that were highlighted in its first review (such as the quality of the rating process or conflicts of interest), and would analyse any modifications in the provisions of the CRA codes that have been introduced since the first review.
7. In June 2007, as part of the second review and following a letter from the European Commission received 7 May 2007, CESR launched a questionnaire regarding the Rating of Structured Finance Instruments.
8. In September 2007, CESR received a letter from the European Commission requesting CESR to undertake further analysis in relation to several aspects of the rating process regarding structure finance instruments (CESR 07/608).
9. In October 2007, CESR held separate hearings with the 4 CRAs. During these sessions, the CRAs provided CESR with updated information on their codes of conduct, discussed the Commission's new request including their views on the sub-prime crisis and particularly on how they intended to address any possible shortcomings in this market.
10. In November 2007, as a follow up to the meetings held with rating agencies at the beginning of October, CESR sent a letter asking for additional information to the CRAs. CESR has published on its website the list of questions (CESR/07-781) and the answers provided in December 2007 by the CRAs (except those expressly requested by the CRAs to be kept confidential) (CESR/07-831).
11. In February 2008 CESR published a consultation paper on the role of CRAs in structured finance (CESR/08-36) to seek market participants' views before the end of March 2008 on the main issues arising from the activity of the CRAs in the structured finance market and, in particular, on their views on possible policy options. CESR received 26 responses to its consultation before the closing date. Those that are public can be viewed at CESR's website. Besides, CESR organised an open hearing for interested market participants (rating agencies excluded) on the 26th March at CESR premises in Paris.



12. CESR is an independent Committee of European Securities Regulators. The role of the Committee is to:
- Improve co-ordination among securities regulators;
 - Act as an advisory group to assist the EU Commission, in particular in its preparation of draft implementing measures in the field of securities;
 - Work to ensure more consistent and timely day to day implementation of community legislation in the Member States.
13. The Committee was established under the terms of the European Commission's decision of 6 June 2001 (2001/1501/EC). It is one of the two committees envisaged in the Final Report of the Group of Wise Men on the regulation of European securities markets. Baron Alexandre Lamfalussy chaired this group. The report itself was endorsed by the European Council and the European Parliament. The relevant documents are available on the CESR website.
14. Each Member State of the European Union has one member in the Committee. The members are nominated by the Member States and are the heads of the national public authorities competent in the field of securities. The European Commission has nominated the Director General of the DG Market, as its representative. Furthermore, the securities authorities of Norway and Iceland are also represented at a senior level.
15. For further information please contact:

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