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Mr Andrea Enria
Secretary General
CEBS
Floor 18 Tower 42
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RE: Consultation Paper on the recognition of External Credit Assessment Institutions

Dear Mr Enria,

Standard & Poor's Ratings Services ("Ratings Services") appreciates the opportunity to comment on the "Consultation Paper on the recognition of External Credit Assessment Institutions" ("CP07") of the Committee of European Banking Supervisors ("CEBS"), in connection with implementation of the European Union ("EU") Capital Requirements Directive ("CRD").

Ratings Services supports CEBS' efforts to work towards common guidelines for the recognition of External Credit Assessment Institutions ("ECAIs") based on a transparent consultation process to minimise the administrative burden for the ECAI recognition process at EU level. International consistency of ECAI recognition processes and requirements, in particular within the EU, will be key to minimising compliance costs for prospective ECAIs and helping banks and investment firms that wish to make use of ECAIs' credit ratings for regulatory capital purposes.

Ratings Services strongly supports CEBS' proposal for a "joint assessment process" ("JAP") to facilitate the recognition of ECAIs that are internationally active. Ratings Services believes this approach would significantly reduce the time, cost and complexity of the recognition process, subject to the incorporation of some practical safeguards.

Ratings Services believes that the recognition criteria should take into account market acceptance and credibility as key inputs into the recognition process, as well as backtesting and the quality of public disclosure in the determination of the amount of information and degree of investigation necessary for recognition of an ECAI. Public disclosure by ECAIs of their rating methodologies, their policies for achieving and maintaining consistency of methodology and ratings, and their default and transition studies ("backtesting") is key to a transparent rating methodology. Backtesting is the best validation of the effectiveness of ratings.

Ratings Services is committed to enhancing the transparency of its own rating process and believes that the competent authorities should, in deciding on recognition of an ECAI, rely on information that is publicly available. Confining the requirements to publicly available information would enhance the transparency and accountability of the ECAI recognition process. In addition the competent authority and the ECAI would be able to refer third parties to the publicly available information to enable them to make, should they so wish, their

own evaluation of that information in assessing the recognition process. Ratings Services already publishes on its website¹ details of its rating methodologies and criteria and backtesting information.

Ratings Services has been an advocate of enhanced transparency for credit rating agencies and strongly supports the recent Code of Conduct Fundamentals (the "IOSCO Code"), published by the International Organisation of Securities Commissions ("IOSCO"). Whilst we recognise the different nature of the interests of securities markets regulators and prudential supervisors, many of the issues addressed in CP07 regarding "objectivity", "independence", "on-going review" and "transparency and disclosure" are also effectively addressed by the IOSCO Code.

Ratings Services fully supports the essential purpose of the IOSCO Code, which is to promote investor protection by safeguarding the integrity of the rating process. The means to achieve this is for rating agencies to adopt and publish their own proprietary codes of practice based on the principles set out in the IOSCO Code. Ratings Services believes that its own Code of Practices and Procedures, which is available on its website, is consistent with the principles set out in the IOSCO Code and appropriately implements IOSCO's Statement of Principles Regarding the Activities of Credit Rating Agencies published in September 2003.

In light of this, Ratings Services believes that competent authorities should refer to ECAIs' publicly available proprietary codes, where relevant, rather than seeking additional information on the measures taken to address policies on "objectivity", "independence", "on-going review" and "transparency and disclosure". Compliance with the principles of the IOSCO Code should address many of CEBS' conditions for ECAI recognition. Moreover, if CEBS and IOSCO follow parallel approaches, this will limit the risk of establishing duplicative, and possibly contradictory, criteria.

This letter answers the questions posed in CP07 and makes additional comments that Ratings Services believes relevant to understanding its position. The first section of this letter addresses general issues regarding the recognition process, and the JAP in particular; the second section responds to the specific questions posed by CEBS; and the third section provides comments on the annex to CP07, concerning the common basis application pack.

PART 1– COMMENTS ON THE RECOGNITION PROCESS

Joint Assessment

As a matter of principle, Ratings Services does not promote the use of its credit rating opinions for regulatory purposes. Ratings Services would expect that in many cases competent authorities might choose to recognise ECAIs directly, based on the authority's own knowledge and experience, the names of ECAIs put forward by credit institutions and publicly available information about those ECAIs.

However, Ratings Services appreciates that there may be a desire for it to be recognised as an ECAI in many EU member states and that many competent authorities may seek information from it to facilitate recognition. In the light of this, it would appear to be unnecessarily burdensome if Ratings Services were required to provide information directly to the competent authority in each member state. This could also generate inconsistencies in implementation, adversely affecting the integrity of the recognition process. Ratings Services therefore strongly supports the JAP.

¹ www.standardandpoors.com

Ratings Services believes that if national competent authorities request additional information, beyond that provided through the JAP, this is likely to impose a disproportionate cost on ECAIs and could lead them to consider withdrawing from the process. Ratings Services therefore urges CEBS to make the JAP as open and comprehensive as possible so as to minimise the possibility of competent authorities requesting additional information.

In any event, it is unclear from CP07 what national discretion will be granted to require additional information in this way. Ratings Services encourages CEBS to specify in the framework for the JAP a strictly limited set of specific factors that justify a national competent authority to request additional information. Competent authorities should, where possible, make requests for additional information through the process facilitator, and, in any case, clearly justify the reason for the request for additional information. The JAP should also contain a framework for dealing with cases where the ECAI objects to the request on the grounds that it is unnecessary or unduly burdensome.

For international ECAIs without an apparent EU “home member state”, such as Ratings Services, it is unclear how the JAP will be conducted and, in particular, how the process facilitator will be chosen. Ratings Services believes that, in these circumstances, CEBS should consult with the ECAI, and take its comments into account, before making any decision on the selection of the process facilitator.

CP07 only briefly discusses the important issue of the on-going review of the eligibility of an ECAI for recognition and, in particular, the circumstances in which recognition can be withdrawn. Ratings Services believes that it is important for CEBS to address the process by which recognition can be withdrawn. In particular, any withdrawal process should include a procedure which gives an ECAI and any affected credit institutions an opportunity to respond to, and, if appropriate, appeal against, a decision to withdraw recognition. Common guidelines on the withdrawal of recognition would, as with the JAP, reduce the risk of inconsistencies in the application of the recognition process between competent authorities and so avoid adversely affecting the integrity of the process and enhance the transparency and accountability of the recognition process.

Direct recognition and indirect recognition

A requirement for direct recognition by each competent authority without the JAP would involve ECAIs in very significant work in providing information to each competent authority and handling ongoing compliance. Ratings Services welcomes the establishment of the JAP by CEBS as it should significantly reduce this burden.

However, Ratings Services believes that there is considerable merit in the use of indirect recognition by competent authorities. Ratings Services would urge CEBS to provide guidance that some competent authorities may choose to use indirect recognition rather than either participate in the JAP, or undertake their own direct recognition process in relation to some ECAIs.

Implications for competition

Ratings Services recognises that CEBS’ task is of a prudential nature and it does not intend to use the ECAI recognition process as a tool for influencing the competitive situation in the credit rating business (see paragraph 73 of CP07). However, an excessively detailed and burdensome recognition process may create barriers, which could lead to, amongst other things, smaller domestic or international rating organisations, refraining from seeking recognition.

Assessment of market acceptance

Ratings Services encourages CEBS to use, wherever possible, feedback from market participants to establish that an ECAI has strong market acceptance and that, therefore, it meets the criteria for recognition.

Transparency of the recognition process

Ratings Services believes it is of paramount importance that the recognition process is transparent and welcomes CEBS' suggestion that "supervisors will disclose an explanation of their recognition process and a list of eligible ECAIs" (paragraph 5 of CPO7) as this will enhance the accountability of the competent authorities. As explained at the beginning of this submission, Ratings Services is committed to enhancing the transparency of its own rating process and believes that all publicly available information provided to competent authorities to facilitate recognition should continue to be publicly available.

PART II- ANSWERS TO THE QUESTIONS

1) If you are an institution or an ECAI, how do you envisage using the proposed recognition process, in particular in cases where applications for the same ECAI are submitted in more than one Member State at the same time?

Ratings Services considers that it is essential that there is consistency in the recognition process and criteria and a strict limitation on the bureaucratic burden imposed on ECAIs. As such, we strongly favour prioritisation of the use of the JAP. Ratings Services endorses CEBS' suggestion to designate a "process facilitator", which would act as coordinator for all the competent authorities participating in the JAP in respect of that ECAI as this would significantly reduce the number of relationships that would otherwise have to be established.

Ratings Services agrees that recognition at group level is the most appropriate way forward where an ECAI applies substantially the same policies and core methodologies throughout the group. Ratings Services, for example, is part of Standard & Poor's, which is a division of the McGraw-Hill Companies Inc., and it operates through a number of different legal entities internationally. To require recognition on an individual entity basis would increase the burden on an ECAI without providing any apparent benefit where substantially the same policies and core methodologies are applied throughout the group.

Regarding joint ventures and affiliates, Ratings Services accepts that different ownership structures may affect the assessment of the ECAI and that this will need to be taken into account. However, where the joint venture or affiliate uses substantially the same policies and core methodologies as other members of its group, it would appear unnecessarily burdensome to assess these (the policies and core methodologies) separately. In particular, this would appear to increase the risk of inconsistencies in approach.

2) Do you support the proposed joint assessment process? Does it address the need for efficiency, consistency and reduced administrative burdens in light of the CRD requirement that each competent authority make its own decision (direct or indirect) on eligibility?

As mentioned above, Ratings Services supports the JAP. Ratings Services believes the JAP is a pragmatic approach which should help address the need for efficiency, consistency and reduced administrative burdens and which is in the interest of ECAIs, competent authorities and credit institutions.

As mentioned above, Ratings Services supports indirect recognition as a method of recognising ECAIs. In some cases, competent authorities may prefer to use indirect recognition rather than direct recognition. Allowing for the possibility of indirect recognition respects principles of better regulation.

We set out proposals for enhancements to the JAP in our response to question 3 and the comments on the Common Basis Application Pack below.

3) What are your views on the proposed common understanding of the CRD recognition criteria to be implemented by supervisors in determining the eligibility of ECAIs?

Ratings Services broadly supports CEBS' approach concerning the common understanding of the CRD recognition criteria, subject to the concerns indicated below.

Ratings Services believes that, if an ECAI can demonstrate the consistency of its ratings through backtesting and market acceptance and credibility, it is unnecessary for the competent authority to undertake a detailed analysis of rating methodologies and criteria in order to satisfy itself that the ECAI meets the CRD recognition criteria. Ratings Services therefore believes that any common understanding should make clear that competent authorities should adopt this approach.

Ratings Services believes it is appropriate for ECAIs to make reference to their (publicly available) proprietary codes where relevant, rather than being asked to report separately on measures addressing policies on "objectivity", "independence", "on-going review" and "transparency and disclosure".

Set out below are Ratings Services detailed comments on the Part 2 of CP07 concerning "Common understanding of the ECAI recognition criteria laid down in the CRD" (paragraphs 65-114).

Methodology

Ratings Services welcomes the fact that CEBS recognises that no particular type of methodology should be seen to be endorsed (paragraph 81). However, we recall that "the line between the regulation of process and the regulation of content and opinion may prove hard to draw"². We therefore urge CEBS to strengthen this point by rephrasing paragraph 86 to make clear that competent authorities "must not" undertake a detailed assessment of the exact methodology used by the ECAI³.

Ratings Services endorses CEBS' emphasis on using quantitative evidence, such as default or transition studies, to demonstrate the consistency and discrimination of an ECAI's credit ratings.

Ratings Services notes that, in some cases, country specific data sets are likely to be too small for analysis on a stand-alone basis and that doing so would lead to statistically insignificant figures for a number of EU Member States. Ratings Services considers that the data is sufficiently robust in Europe, on a regional basis, to demonstrate the necessary trends. We also note that a strict assessment, on a country-by-country basis, of individual data sets could pose problems for ECAIs with a relatively small set of outstanding ratings.

Independence

Ratings Services welcomes CEBS' statement in paragraph 92 that the onus should be on ECAIs to demonstrate that they have adopted appropriate internal practices and procedures and believes that this approach reflects the current international thinking on rating agencies in the securities area.

² European Parliament resolution on Role and methods of rating agencies (2003/2081(INI)) at paragraph 13

³ The second sentence of paragraph 86 in CP07 reads "Competent authorities *should* [emphasis added] not undertake a detailed assessment of the exact methodology used by the ECAI, but should instead satisfy themselves that the credit assessment drivers used in the ECAI's methodology are sensible predictors of creditworthiness, and that the ECAI's internal procedures ensure that its predefined credit assessment methodology is applied consistently in the formulation of all credit assessments within each broad asset class or market segment."

Ongoing Review

The provisions regarding ongoing review (paragraphs 93-101) raise some concern and would benefit from further clarification. In accordance with Ratings Services' established policies and procedures for surveillance, unless the issuer requests a rating without surveillance, once a rating is assigned, Ratings Services monitors the issuer on an ongoing basis. CEBS should not adopt a prescriptive approach to such monitoring, especially to the extent it might limit ongoing monitoring and timely updates, including whenever the ECAI becomes aware of any information that might occasion a rating action, consistent with the applicable rating.

Interaction with management/solicited vs unsolicited ratings

Ratings Services believes that contact with the senior management of a rated entity offers valuable insight into the entity concerned. However the extent of interaction with the senior management varies in individual cases.

Unsolicited ratings are ratings assigned by Ratings Services without the full participation of issuers in the rating process. Ratings Services reserves the right, in its sole discretion, to issue rating opinions without the full participation of issuers in the rating process if Ratings Services believes there is a meaningful credit market or investor interest served by the publication of such a rating and it has sufficient information to support adequate analysis.

Changes in methodology

Ratings Services publishes its ratings definitions and default and transition studies on a regular basis, and makes them freely available to the public on its public website. It also makes its criteria and methodologies freely available to the public on its public website. Whenever practicable, Ratings Services makes significant modifications to its criteria and methodologies freely available to the public on its public website prior to implementing such modifications in its rating and surveillance processes. Ratings Services would appreciate clarification on the definition of material as viewed by CEBS so there could be no misunderstanding about our ability to comply with this provision.

Credibility and Market Acceptance

Ratings Services believes that credibility and market acceptance are key to the success of a rating agency. As mentioned above, Ratings Services does not promote the use of its credit rating opinions for regulatory purposes and believes that regulatory status, including ECAI recognition, would be of limited value without credibility among users of ratings. Ratings Services considers that competent authorities should check with institutions which rating agencies' ratings they intend to use for CRD purposes, rather than an ECAI having to name institutions that would use its ratings.

Transparency and disclosure of individual rating assessments

Ratings Services broadly disseminates all of its public credit ratings and related commentary through real time posts on its website, a wire feed to the news media, subscription services such as Ratings Direct and Credit Wire as well as through more traditional print publications. However, as Ratings Services has about 150,000 outstanding ratings globally, as a practical matter, it does not wish to publish a complete list of its ratings on its website, as paragraph 114 suggests it should be required to do. Rating Services believes that it can demonstrate that it meets the criteria that individual credit assessments are accessible at equivalent terms at least to all credit institutions having a legitimate interest in those individual credit assessments and that its credit assessments of securitisation positions are available publicly to the market, without posting a list of all ratings on its website or otherwise maintaining a publicly available list. Ratings Services believes that any common understanding of the ECAI recognition criteria should not provide a specific definition of what constitutes satisfaction of this requirement.

4) What are your views on the proposed approach for implementing the mapping process?

Whilst the mapping process is a key element for the consistency of ECAI recognition, Ratings Services considers that it is the responsibility of the competent authorities to assess the correspondence, if any, between ratings of different ECAIs.

To achieve a robust approach to mapping, competent authorities may want to use different criteria and analytical tools, the most obvious one being the comparison of default statistics by rating category published by ECAIs. It should be noted in this respect that, before comparing ECAIs' data, competent authorities should closely familiarise themselves with the definitions and assumptions underpinning the data, as this may be different between ECAIs.

When such figures are not available, competent authorities may rely on a combination of both qualitative and quantitative criteria (for instance, comparing the ratings from different ECAIs for the same credit (issuer or specific security), assessing the rigor of the rating process and reviewing criteria published by ECAIs).

In any event, the mapping process must be transparent, with a clear explanation of the rationale for the approach taken on mapping. It may be beneficial for competent authorities to release their draft approach to mapping for public comment.

As an underlying principle, the mapping process should strictly refrain from making a regulatory judgment on the methodology used by the respective ECAIs.

5) Do you support the proposal that the "mapping" of credit assessments to risk weights should also be addressed under the joint process set out in Part 1 for applications made in more than one Member State?

As a general principle, Ratings Services supports a widespread use of the JAP in each aspect of the recognition process. This is particularly important in the mapping process, as different mapping results for each competent authority would compromise the universal definition of each rating category and “notch”, causing a differentiation of an individual rating position between EU member states. Consistency on mapping is most vital for institutions using the standardised approach, as different approaches to mapping would lead to confusion, for example, in cases where a particular rating category from a particular rating agency is treated differently in different EU member states.

6) Do you think that the concept of loss, rather than default probability alone, is the appropriate key parameter for mapping securitisation credit assessments? If not, what should be the appropriate parameter? How should it be measured statistically? To what extent do the same considerations apply for CIU credit assessments?

Ratings Services' ratings definitions are based on the probability of default. Moreover, Ratings Services uses observed defaults on rated securities in its default and transition studies to do the backtesting of its ratings for both issuer ratings and ratings of securitized issues. This does not mean that other parameters are not useful, and

Ratings Services makes use of these parameters for some purposes (for example, loss given default, loss severity indicators, time before recovering claims).

The relative scarcity of reliable recovery data in Europe however, makes the probability of default measurement globally the most relevant and easily available indicator, and establishes comparability and a level playing field between ratings on securitized and non-securitized exposures. Loss data on securitised exposures is almost non-existent. Moreover, the fundamental formula of “Risk-weighted exposure amount” in the CRD and “Capital Requirement” in Basel II uses a multiplication of probability of default and loss given default. Incorporating loss in mapping securitisation credit assessments could lead to double counting and an outcome which differs from the approach taken in relation to non-securitised credit assessments.

PART III– COMMENTS ON THE COMMON BASIS APPLICATION PACK

Comments on the Common Basis Application Pack (Annex of CP07)

Single information package

Ratings Services welcomes CEBS’ efforts to draw up a list of information requirements for the performance of the JAP. It is important that ECAIs can satisfy national requirements with a single information package. We believe that it should be possible to satisfy the information requirements for Ratings Services with information that is already in the public domain.

However, in some cases, the Common Basis Application Pack suggests requirements for information that Ratings Services believes would not be of significant benefit and would place disproportionate burden on an ECAI.

Ratings Services believes it is appropriate for an ECAI to make reference to their (publicly available) proprietary codes where relevant, rather than being asked to report separately on measures addressing policies on “objectivity”, “independence”, “on-going review” and “transparency and disclosure”.

We note that some requests require that a matter be “demonstrated” and/or “certified” by the ECAI. Ratings Services believes that it should be possible for a competent authority to recognise an ECAI on the basis of information provided by the ECAI relating to specified topics. The use of these terms could cause confusion in the operation of the JAP and give rise to inconsistencies between the approach of different competent authorities.

Objectivity

Whilst implementation of ratings methodologies may vary among countries and sectors, Ratings Services believes that a detailed explanation of the differences in the ratings of a specific industry between two EU member states is unlikely to be of any benefit to any competent authority. Therefore, where questions arise for a competent authority regarding the possibility of differences applicable to ratings in their EU member state, these should be addressed through the JAP.

Ongoing review and contact with senior management

See discussion above regarding our concerns as to the nature of the disclosure that CEBS seeks in this regard.

Revenue and fee disclosure

It has long been Ratings Services' policy, as well as the industry-standard, to charge issuers for ratings and surveillance while providing ratings opinions free of charge to all investors and the public at large. Ratings Services has a firm commitment to ensuring that any potential conflicts of interest do not compromise analytical independence. Ratings Services' many policies and procedures safeguard the integrity of the rating process. Ratings Services rates such a large number of issuers that no one issuer is responsible for more than a very small portion of Ratings Services' revenue, and therefore Ratings Services' analytical independence is not susceptible to compromise.

It should be noted that disclosure of specific fee amounts would not add any material benefit to a competent authority's assessment. In addition, Ratings Services' desire for information that it provides to the competent authority to be publicly available would conflict with a requirement to disclose specific fee amounts due to the commercial confidentiality of its client agreements.

Yours Sincerely,

A handwritten signature in cursive script, appearing to read "Paul Rigall".