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FEEDBACK STATEMENT

CESR's consultation on CRAs Central Repository

October 2009

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PART I: Introduction

1. On 12 November 2008, the European Commission published a Draft Regulation on credit rating agencies (CRAs). The amended version of this regulation was approved on 23 April by the European Parliament[1]. The jurist linguistic revision took place and the European Council approved the document on the 27 July 2009[2]. The European Council[3] signed the Regulation on the 16th September 2009. It is expected to enter into force 20 days after it will be officially published in the Journal Official of European Commission by November 2009 and to apply by May 2010.

2. According to this proposal CESR will discharge important co-ordination and advisory functions alongside with its traditional role of promoting convergence through Level 3 guidelines and recommendations.

3. Among other tasks, according to the Commission's proposal article 11(2) and 21(2) lit. d), CESR shall:

   - Establish a central repository (CEREP) where credit rating agencies shall make available information on their historical performance data including the ratings transition frequency and information about credit ratings issued in the past and on their changes;

   - Define the standardised form in which the credit rating agencies shall provide information to that repository;

   - Make that information accessible to the public and publish summary information on the main developments observed on an annual basis (Art. 11 (2));

   - Issue guidance on common standards on the presentation of the information, including structure, format, method and period of reporting, that credit rating agencies shall disclose in accordance with Article 11(2) and Annex I, Section E, Part II, Point 1[4] of the Regulation proposal.

4. CESR has to provide guidance on common standards on the presentation of historical performance data within 6 months of the entry into force, i.e. for April 2010. There is no deadline with regard to the implementation of the central repository. This step will highly depend on the need for a public tender process and of IT development work.

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[1] http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2009-0279+0+DOC+XML+V0//EN&language=EN#BKMD-56

[2] http://register.consilium.europa.eu/servlet/driver?page=Result&lang=EN&ssf=DATE_DOCUMENT+DESC&fc=REGAISEN&srm=25&md=400&typ=Simple&cmsid=638&ii_PUBLIC_DOC=%3E0&ff_TITRE=credit+rating+agencies&ff_FT_TEXT=&ff_SOUS_COTE_MATIERE=&dd_DATE_REUNION

[3] http://register.consilium.europa.eu/servlet/driver?lang=EN&ssf=DATE_DOCUMENT+DESC&fc=REGAISEN&srm=25&md=400&typ=Simple&cmsid=638&ff_TITRE=credit+rating+agencies&ff_FT_TEXT=&ff_SOUS_COTE_MATIERE=&dd_DATE_REUNION=&rc=1&nr=25&page=Detail

[4] Annex I, Section E, Part II, point 1 refers to "Every six months, data about the historical default rates of its rating categories, distinguishing between the main geographical areas of the issuers and whether the default rates of these categories have changed over time"

5. As an initial step in the analytical process to develop common standards and the technical specifications for the CEREP, CESR gathered information on the historical and performance data available from CRAs by means of questionnaires.

6. Based on the information gathered through the analysis of the questionnaires, CESR published for comments a Consultation Paper on 09 July 2009 on the conclusions CESR has drawn for setting common standards for presentation of historical and performance information and for the design of the potential output from the CEREP. The consultation closed on 07 August 2009. Fifteen responses to the consultation were received, all respondents coming from the credit rating and banking sectors. All responses that have not been marked as confidential are available on CESR's website under the heading 'Consultations' at www.cesr.eu.

7. This feedback statement provides a summary of the main suggestions received by CESR regarding the setting of common standards for presentation of historical and performance information and the potential output design of the CEREP along with an explanation of CESR's decision on some of the most significant issues raised.

PART II: General Comments

8. Most respondents expressed a general support for the proposals in CESR's Consultation Paper and welcomed the outcome that is supposed to be achieved. At the same time, commentators gave CESR helpful advices and suggestions on how to enhance the data quality and efficiency of the central repository. CESR thanks all respondents for their valuable input.

9. Two respondents raised general concerns regarding the input/output of the CEREP, primarily due to concerns regarding the statistical significance and the comparability of the data provided in the CEREP as well as potential disadvantages for small CRAs relating to some of the indicated calculation methods. In this regard, one respondent argued strongly for the introduction of a raw data approach.

10. Additionally, several respondents worried about potential costs and efforts that might arise for CRAs by providing data and calculations to the CEREP.

11. Some larger CRAs appeared also to be concerned about their ability to provide historic data in the comparable format CESR suggested in the Consultation Paper in terms of ratings categories, data categories, time periods and methodologies.

CESR considered carefully all these issues and decided to ask CRAs to supply 'raw data' instead of statistical data. Based on the 'raw data' CESR will compile the performance statistics itself. By adopting this technical option, CESR meets the primary goal of the CEREP which is to enhance transparency and to contribute to the protection of investors. At the same time, CESR takes into account the concerns on the statistical significance, on comparability and on potential disadvantages for small CRAs. Furthermore, this approach benefits CESR by reducing controls points, simplifying guidelines and allowing a better scalability of the CEREP and CRAs.

> To achieve this objective, CRAs will be asked to supply the CEREP with reports containing data files characterising the ratings. Since CESR intends to compute the performance statistics itself costs for CRAs will be minimised.
>
> CRAs will supply the CEREP with data on historical ratings which were already in existence at the time of the entry into force of the regulation. CRAs will not be required to recalculate the data. However, they will be requested to send 'raw data' on these historical ratings. CESR is convinced that this approach is best suited to minimise the cost burden for CRAs and meets the goal of the Regulation.

12. One respondent raised the question of intellectual property rights regarding the information publicly provided in the CEREP and suggested to limit the download possibilities.

> CESR sees intellectual property of the CRAs sufficiently protected since most of the information that they have to provide to the CEREP is currently published free of charge by the CRAs themselves. Additionally, the possibility of a comparison between the performance of the CRAs, which is i.a. intended to achieve by the CEREP, would in CESR's view be limited by the suggestion provided.

13. Another respondent requested that third country CRAs without systemic importance will be exempted from the disclosure requirement in Article 9(2) of the regulation. As well, one respondent suggested a phase-in approach, in which CRAs would not have to fulfil disclosure requirements by the regulation immediately after entry into force but at some later stage.

> Both suggestions were considered by CESR as not meeting the spirit of the regulation and thus rejected.

14. Additionally, CESR noted that some remarks in the respondents' answers would exceed the framework provided by the regulation by far. Therefore, they have not been taken into account.

PART III: Scope of the Central Repository

15. CESR notes there were two opposite blocks of respondents relating to the question of geographical scope in accordance with the article 2 of the Regulation; one in favour of a global approach including all ratings issued in the statistics, the other in favour of a strict limitation on ratings issued or endorsed by CRAs registered in the Community.

> CESR thus decided to give CRAs the option to report either according to CESR's definition (CESR agreed on the suggestions provided regarding Para 20 of the Consultation Paper and slightly modified its definition as such "In accordance with the scope of article 2 of the Regulation, CESR opts for the inclusion of all credit ratings (i) issued or endorsed by credit rating agencies registered in the Community, or (ii) issued by any certified credit rating agency which are disclosed

publicly or distributed by subscription") or on a global basis. However, the preliminary condition is that the reporting must be consistent across all asset classes as well as reporting dates for a CRA. Additionally, an explanation is mandatory if a non-global approach is taken. In case of an endorsement of credit ratings issued by a subsidiary (that has not yet been reported for) at a later stage, CESR expects a full report of all historic data as provided by the endorser at the time of registration.

16. One respondent notified CESR of a misstatement in the CEREP in Para 31: Structured Finance ratings shall be reported on issue basis and not on issuer basis.

> CESR agrees and will modify the CEREP concept accordingly.

PART IV: Common Standards for the Presentation of Information in the Central Repository

17. One CRA has doubts about the legal base to ask for historic data at all.

> CESR verified this legal aspect, maintains its position and sticks to the reporting requirement for historic data with the limitations mentioned in CESR'S proposal at the end of the item 11.

18. As well, a number of CRAs raised doubts whether they will be able to report reliable data in the time frames provided by CESR.

> CESR decided to extend the latest reporting date to three months instead of two after the end of the reporting period.

19. Others were concerned that in some cases rating categories might be too small or reporting periods might be inadequate.

> CESR considers those concerns when setting final standards for the categories. Data will only be published if a reasonable sample size is available.

20. A number of CRAs raised concerns about the two categories of withdrawals introduced by CESR for differing reasons, such as their difficulty to track ratings withdrawals in their database, the absence of segmentation by cause of withdrawal, and also the multiplicity of reasons which could explain a withdraw or a discontinuation of a rating.

> CESR considers it as valuable information to aggregate number of rating withdrawals into the CEREP. Thus CESR decided to introduce the following new categories to distinguish the reason for a rating withdrawal:
> 1) Incorrect or insufficient information provided,
> 2) Bankruptcy of rated entity or debt restructuring
> 3) Reorganisation of rated entity (including merger or acquisition of rated entity),
> 4) Maturity of the debt obligation,

5) Automatic invalidity of rating due to business model of CRA in case of a subscription based rating model.
6) End of rating due to other reasons.

21. Regarding the treatment of unsolicited ratings, responses varied widely. Most respondents against the inclusion of unsolicited ratings brought up the argument that the data used in unsolicited ratings is not as good as in solicited ratings considering those ratings are only based on publicly information and do not have the same depth of analysis as the solicited methodology's approach.

CESR reminds that the data quality of unsolicited ratings have to be enough sufficient to issue a rating otherwise the CRAs shall refrain from issuing a rating. CESR thus decided to require CRAs to report all solicited and unsolicited ratings according to the definition in article 10 (5) of the regulation and to identity both type of ratings as requested herein.

22. Some respondents argued that the definition of default varies between credit rating agencies.

CESR agrees with this view. Thus, the set of the three conditions mentioned in the Para 72 of the Consultation Paper may be seen as a minimal standard definition of default. In case of divergences, CRAs are required to describe in the qualitative part of the CEREP their own definition of default, how they diverge from the standard and the consequences thereof for the significance of default statistics.

Corporate Finance

23. Several CRAs faced some difficulties with the industrial segmentation proposed by CESR and suggested to use a more basic industry segmentation.

CESR decided to ease the burden for CRAs by considering appropriate the suggestion made and allows the CRAs to report for Corporate Finance in three segments:
1) Financials institutions including banks, brokers and dealers
2) Insurances
3) Corporate issuers that do not belong to class 1) or 2)

24. Some CRAs rejected CESR's proposal for the treatment of subsidiary ratings, arguing about the difficulty to classify subsidiaries formerly and currently rated as autonomous or fully integrated into their parents.

CESR agrees with some of the reasons brought up. Therefore, CRAs decided to treat subsidiary ratings as they deem appropriate. However, this treatment has to be consistent over time and must be explained in the qualitative part of the CEREP.

25. Two respondents reserved judgement regarding the inclusion of short-term ratings.

CESR decided to include them nevertheless, since, in CESRs view, there are asset classes where short-term ratings are used as rating standard.

Sovereign and Public Finance

26. A number of respondents raised questions regarding different aspects of the suggested geographical breakdown in the Consultation Paper.

CESR pays attention to the expressed reservations and decided to review its approach by establishing a basic common standard upon geographical segmentation defined as such: World, Continental, Country. A category called "International" will be added to address multinational organizations.
Concerns regarding statistical significance will be addressed. Data will only be published if a reasonable sample size is available.

27. One respondent requested the inclusion of US municipality securities as a separate category from sub-sovereigns.

CESR understands the reasoning for the inclusion but notes that a split between sub-sovereigns and municipalities would be artificial as in some countries the borderline between the two of them is not clearly drawn. CESR maintains the segment proposed in the Consultation Paper as sufficient for users needs.

28. Some respondents requested to not include both, foreign and local currency ratings.

CESR considers that the distinction between local and foreign currency ratings adds value to the users considering the regulatory use of and the underlying differences between those two types of rating and will include both in the CEREP. Therefore, CESR will stick to ask for both local and foreign currency.

Structured Finance

29. A number of respondents were concerned regarding the distinction of the domicile of the securitization. Most agreed that the use of the domicile of the majority of the underlying assets as the primary variable to define the region of the issue is appropriate. However, they argue that the asset pools sometimes are blended and there is not a clear majority of underlying assets from any one country.

CESR thus decides to introduce the new category "International" for blended asset pools if no relative majority of underlying assets from any one country can be identified. This decision applies for the Structured Finance ratings and Sovereign & Public Finance ratings.

30. One respondent did not agree with the suggested geographical breakdown of Structured Finance in the Consultation Paper.

> CESR pays attention to the expressed reservations and decided to review its approach by establishing a basic common standard upon geographical segmentation defined as such: World, Continental, Country. A category called "International" will be added to address multinational organizations.
>
> Concerns regarding statistical significance will be addressed. Data will only be published if a reasonable sample size is available.

31. One respondent asked for more detailed information regarding the origination of the securitization (i.e. country of arranger, etc.).

> CESR's proposal regarding information about the origination of securitization is in line with the scope of the CEREP which does not include other information than rating performance data. The goal is to enhance transparency and to contribute to the protection of investors but not to supply investors with information on structural details of ratings.

32. A number of the respondents were concerned about the proposed Structured Finance asset classes in CESR's Consultation Paper. .

> CESR decides to amend its definitions in view of the provided suggestions and the following changes will be made:
> 1) Auto loan securities will be treated as a distinct category,
> 2) Whereas boat and airplane securities will be categorized in "other ABS",
> 3) Securities backed by leases thereof fall in the same asset classes,
> 4) Home Equity Loans will be grouped in the RMBS sector instead of ABS,
> 5) Segmentation of Collateral Debt Obligations remains unchanged.
>
> As a consequence, the new asset-classes including subcategories for Structured Finance are as follows:
> 1. ABS:
> – Credit card receivable backed securities,
> – Auto loan backed securities,
> – Other ABS.
> 2. RMBS:
> – Home equity loans,
> – Prime RMBS,
> – Non-prime RMBS.
> 3. CMBS
> 4. CDO:
> – Cash flow and hybrid CDOs/CLOs,
> – Synthetic CDOs/CLOs,
> – Market value CDOs.
> 5. ABCP
> 6. Other

33. Several respondents raised the relevancy of using short-term ratings and long-term ratings in Structured Finance.

> CESR proposes to generally limit the reporting requirement to long-term issue ratings. That is unless the market standard for this category is different, such as short-term issue ratings for ABCP programs.

PART V: Output Design of the Central Repository

34. CESR decided to use a "raw data" approach as the reporting standard of the CRAs to the CEREP. Raw data will not be published in the CEREP as they will be computed by CESR to provide output in terms of number of ratings and rating actions, (cumulative) default rates and (cumulative) transitions matrices presented in a form similar as suggested in "Structure of information presented in the CEREP" part of the Chapter V of the Consultation Paper. Data will only be published if a reasonable sample size is available. By doing so, CESR addresses concerns regarding statistical significance and comparability between the CRAs.

As well, CESR takes into account other suggestions provided on Navigation in the CEREP and additional qualitative information parts.

By this approach, CESR will use a technical alternative that best meets the needs of investors in terms of transparency and comparability on one hand and small and large CRAs in terms of costs and comparability on the other hand. Indeed, CESR considers the 'raw data' approach to be the most cost-efficient way to build the CEREP. In addition, the chosen approach will enable CESR to react flexibly to market changes and innovations.