



The voice of banking
& financial services

The European Commission
Directorate General Internal Market and Services
Rue du Spa, 2
B-1000 Brussels

7 January 2011

Dear Sir or Madam,

PUBLIC CONSULTATION ON CREDIT RATING AGENCIES

The Association for Financial Markets in Europe (**AFME**) and the British Bankers Association (**BBA**)¹ welcome the opportunity to comment on the Public Consultation on Credit Rating Agencies published by the European Commission (the **Commission**) on 5 November 2010 (the **Consultation Paper**), and are keen to be part of any future ongoing dialogue in relation to the issues raised by the Consultation Paper and the reform of the provision and use of credit ratings.

We summarise below our high-level response to the consultation. This is followed by answers to the individual questions raised in the Consultation Paper.

Executive Summary

The need for reflection, the reality of ratings performance in Europe and the need for public policy to encourage investor participation, liquidity and cost-effective, stable funding

Before addressing the points raised in the Consultation Paper, we would like to make some preliminary points.

There is a clear need to ensure that regulatory reform is undertaken with due care, following a cost-benefit analysis and at a considered pace. In our opinion, given the relative novelty of Regulation (EC) No 1060/2009 (the **CRA Regulation**), it is too early to consider making material changes to the CRA regulatory framework. The political pressure (which we understand) to reform CRAs further, in particular in the sovereign space, is not grounded in any evidence that ratings in Europe have failed to perform according to expectations. Further changes should only be made once there has been sufficient time to reflect upon and meaningfully assess the impact of recent changes upon CRAs, markets and market participant behaviour. That assessment should further take into account the numerous other regulatory

¹ A description of the associations is set out in Annex 1.

changes that have occurred in the last two years and those which are due for implementation. For example, a horizontal assessment of the cumulative impact of CRD2, CRD3, MiFID2, Solvency 2 and the CRA current and future regulation on securitisation markets has not yet been undertaken.

By continuing to impose regulation upon regulation, often in a piecemeal fashion that overlaps the same market sectors, without leaving time for assessment of the impact of changes, individually and collectively, the European authorities risk designing a regulatory framework that so overshoots the mark that it fails to address the true causes of past problems. The side-effects will be to hinder the development and recovery of markets, and in turn limit the funding available to help European issuers (including sovereigns) recover from the difficulties of recent years. European banks face significant funding challenges in the next several years in order to meet the new liquidity and stable funding requirements of Basel 3 (see further below). In our view it is essential that public policy supports and encourages free and transparent funding markets governed by evidence-based, well calibrated regulation, rather than wholesale actions which drive investors away, increase funding costs and delay economic recovery.

The reality of ratings performance in Europe often differs from its perception. For example, in structured finance, one sector which has suffered particular stress through the financial crisis, the evidence is that ratings in Europe have been relatively stable and rating migration has been limited.² For sovereign ratings, the IMF has commented recently that “As to accuracy, sovereign ratings are found to have generally performed well”³.

Reliance on ratings

At the outset, we wish to emphasize that we agree that overreliance on credit ratings should be discouraged. We support sensible regulation that incentivises investors to use credit ratings as part of, but not to the exclusion of, their own independent risk review and analyses of the instruments in which they invest. However, we are not aware of any of our members who have ever, still less today, relied solely on credit ratings to make investment decisions.

Nevertheless, the positive value of credit ratings as an input into prudential standards and risk management practices should not be underestimated. Credit ratings advance transparency and consistency of capital standards because these inputs are available to all market participants and financial supervisors. In certain circumstances, credit ratings may also provide investors with access to more detailed and risk sensitive analyses of creditworthiness than can (at least in most cases) be produced internally. Recognizing that approaches that are appropriate for institutions with

² Performance and ratings migration data for structured finance in Europe can be found on the AFME website at <http://www.afme.eu/document.aspx?id=4084>.

³ <http://www.imf.org/external/pubs/ft/gfsr/2010/02/pdf/text.pdf>

sophisticated internal systems and controls may not be appropriate for smaller, less complex firms, we believe that there should be room for diversity of alternatives based on the size and sophistication of the relevant firm and the nature of the entity(ies) or asset(s) being rated.

Accordingly, the potential for use of external ratings within the prudential framework in appropriate cases should be retained, provided that:

- (a) quality and transparency of ratings is enhanced;
- (b) regulatory supervision of credit rating agencies (**CRAs**) ensures a high standard of minimum competency/quality levels are met;
- (c) investors clearly identify within internal credit risk management frameworks where reliance is placed on external ratings and supplement this reliance with their own independent internal analysis and judgment in appropriate cases; and
- (d) conflicts of interest can be effectively managed.

The measures already in place under the Capital Requirements Directive, and new requirements introduced by the Basel Committee and the EC in the CRA Regulation, and Directive 2009/111/EC (**CRD2**) already largely achieve these objectives⁴. In particular, the CRA Regulation introduces requirements with respect to conflicts of interest and ratings transparency, including new disclosure obligations with respect to rating methodologies and processes. CRD2 and related provisions, which apply generally to investments in securitisation (a sector in which the CRA Regulation also contains specific additional requirements), will ensure that use of external ratings by EU regulated firms will be supplemented with appropriately robust levels of investor due diligence.

Combined with market developments, these initiatives should go a long way towards dealing with many of the shortcomings that emerged following the crisis.

We appreciate the Commission's objectives in considering further reforms to the CRAs sector, particularly in view of the destabilising impact of the recent sovereign debt crisis for global markets, and we support the need for continuing scrutiny of credit ratings and the surrounding regulatory landscape. Even so, we believe that the Commission should proceed with caution in introducing any further mandatory standards, in view of the need to take the recent legislative changes into account and to allow time for their practical implementation to take effect, as well as to align the European response with the Basel standards and other regulatory initiatives (for example, in the United States⁵ and other significant markets) so as to maintain a level playing field. Coordination with the initiatives put forward by US authorities is also important, including monitoring by the Commission

⁴ Although we have some reservations regarding CRD2, see our response to Question 7.

⁵ In accordance with s939(h) of the Dodd-Frank Act

of any revised initiatives introduced following the review of credit rating practices and the feasibility and desirability of further standardisation in the sector, on which the SEC is currently consulting and is due to report in 2011.

Without a broadly consistent global approach to creditworthiness standards for securities, including securitisations, the European authorities risk encouraging arbitrage between different regulatory regimes. In addition, an ill-designed response risks accentuating systemic risk, by replacing regulatory standards and/or business practices with alternatives that may aggravate market instability and increase procyclicality, thus putting Europe at a competitive disadvantage.

Sovereign debt ratings

We support the objectives of increasing transparency and reducing instability in relation to sovereign debt ratings, and agree that more intense scrutiny of the sovereign market may be justifiable in view of the fundamental importance of sovereign ratings to both political and economic stability. Having said that, we remind the Commission that the International Monetary Fund, in its October 2010 Global Financial Stability Report (the **IMF Report**)⁶, stated that "As to accuracy, sovereign ratings are found to have generally performed well."⁷

We share the Commission's concerns, however, that delaying publication of sovereign ratings could heighten risks of market abuse. Delaying disclosure until the close of European trading hours also risks placing local European market participants at a competitive disadvantage in comparison with overseas/international counterparts, and we also believe that it would exacerbate the potential for conflicts of interest, by increasing opportunities for sovereign issuers to exert pressure on CRAs. Analytical independence is of critical importance to market participants.

We recognise that conflicts of interest, if unmanaged, are potentially damaging in the sovereign context, but we are concerned that transferring responsibility for ratings to the ECB or national central banks, or to an "independent" EU public agency, would itself carry inherent conflicts. We have considered what alternatives to the "issuer-pays" model might be feasible in the sovereign ratings context, but have concluded that the alternatives proposed would either themselves also generate their own further conflicts, and/or be unworkable without co-ordination at a global level. Conflicts arising from the "issuer-pays" model may be mitigated by effective regulation and monitoring of sovereign ratings in the same way as with other types of rating.

Competition in the credit rating industry

We concede that the market for CRAs is oligopolistic in nature at a global level, but believe that a reasonable amount of competition is nevertheless

⁶ <http://www.imf.org/external/pubs/ft/gfsr/2010/02/pdf/text.pdf>

⁷ Page xiii of the IMF Report.

present. We do not oppose more competition as a policy objective, although this in and of itself may not remedy the concerns posed by the consultation. Having said that, increasing competition is not easy to achieve as the barriers to entry to new CRAs are relatively high, which is inevitable to an extent given the specialisation of the industry and the resources necessary to establish and maintain a CRA with the requisite credibility and reputation. Indeed, there is a tension between increased regulation, which will tend to raise those barriers further, and increased competition. Further, micromanagement of CRAs' economic models (along the lines of those suggested in section 5 of the Consultation Paper) risks stifling competition, rather than encouraging it.

It is hard to see how deliberately increasing the number of players or introducing state-controlled alternatives to the *status quo* would, in and of itself, increase the quality of service across the sector overall. Increased sectoral and geographical fragmentation of the market would actually create additional burdens for issuers and investors, and create more opportunities for 'ratings shopping'. Information from more sources does not necessarily assist investors either, particularly given the need to understand the different CRA methodologies to assess, analyse, criticise and compare the ratings and could instead undermine the value of ratings as a global benchmark for assessing creditworthiness.

We do not believe it would be appropriate for European or national authorities to intervene by imposing public solutions such as having the ECB, or national central banks, or public/private entities issuing ratings. We do not support intervention to this end. We also believe that public solutions present their own risk of conflict. The creation of new CRAs sponsored or funded by the European or national authorities would potentially create distortions in the market. It would also be likely to impair investor confidence in the independence of ratings, due to the clear potential for conflicts of interest, particularly in relation to sovereign ratings.

Liability of CRAs

We believe that it is important for CRAs to deliver a high standard of service and act with due care, and believe that the existing CRA Regulation will help to achieve this. However, we are concerned that any attempt to introduce a common EU liability standard for CRAs would not be an optimal way to incentivise higher standards. We doubt that a civil liability standard would be consistently applied in practice given the diversity of national legal systems. The costs of a civil liability regime would be passed back to users of ratings – increasing the costs of issuance. We do not believe that there would necessarily be a corresponding benefit in terms of recourse on the part of issuers or investors, given the likely quantum of any claims.

The existing regulatory sanctions regime in the CRA Regulation provides a more workable and proportionate means of incentivising higher practice standards and holding CRAs to account for breach of these standards.

We are also concerned about the negative impact on transparency in the markets given the inhibiting effect an ill-calibrated liability regime would have on the provision of opinions. This could act as an additional barrier to competition, in particular for potential new entrants.

Conflicts of interest due to the "issuer-pays" model

We endorse the principle that the quality and integrity of the ratings process should not be jeopardised by conflicts of interest, and recognise that there is potential in the "issuer-pays" model for this to occur. However, we do not believe that such conflicts have affected the issuing of ratings in Europe more than would have been the case under an alternative model. Furthermore, we believe it is impossible to construct an alternative model which would be free from the risk of conflicts – the risk of bias in favour of the stakeholder who pays will always arise. For the most part, the specific alternatives proposed in the Consultation Paper would also generate their own conflicts of interest.

As a matter of principle, we believe that regulatory authorities should not intervene in free markets to prescribe or prohibit particular business models unless there is strong evidence that the business model has failed and a clear and better alternative model is available that would have avoided such failure. We do not believe that such a failure has been demonstrated in ratings issued by CRAs in Europe⁸. The policy priority should be to ensure that a level playing field exists if a diversity of models is to be developed in response to market demands, and that conflicts in the prevailing models are successfully managed. Evidence suggests that CRAs already manage this process effectively through a combination of independent governance and functional segregation, and these safeguards will be further strengthened by the new minimum standards introduced by the CRA Regulation, which are among the highest in the world.

We urge the Commission to give careful consideration to any further restrictions or requirements to be imposed in the credit rating sector, in view of the complexity associated with reform to the use of ratings, and the extensive changes already made or to be made to this area. Many of these changes are extremely new, and have not yet been given time to work or for their practical effects to become known. This makes it difficult to assess whether further changes are required. Any further changes need to be credible, workable and give certainty to market participants. This will be difficult to establish while extensive reforms are still in the process of being implemented (which is the case today) and their impact on the market remains to be seen. We would also urge the Commission to undertake a detailed impact assessment in relation to the likely costs of the proposed measures as against the benefit to the European market and its supervisors. Measures to move away from the existing model will inevitably have significant resource implications for both private and public sectors. In the current environment the regulatory burden is being continually increased as

⁸ Performance and ratings migration data for structured finance in Europe can be found on the AFME website at <http://www.afme.eu/document.aspx?id=4084>

more and more layers of new regulations, supervisory duties, and compliance challenges are created.

Further changes should be clearly justified; if they are not, there is a risk of unnecessary damage to the industry and the EU market. This will result in less funding being available both to sustain Europe's recovery from recession in the coming years, and to enable Europe's banks to meet the new stable funding ratios required of them under Basel 3⁹, and ultimately increased cost to the consumer.

Questions 1-6:

- (1) Should the use of standardized approaches based on external ratings be limited to smaller/less sophisticated firms? How could the category of firms which would be eligible to use standardised approaches be defined?**

We believe that limiting the use of standardised approaches and requiring financial institutions to produce their own replacement for external ratings would be difficult to implement, time-consuming and challenging for national regulators to monitor and police and prohibitively expensive for the many firms affected.

Standardised v IRB Approach

The current framework differentiates between banks which are on the Standardised Approach and those which are on the IRB Approach. This works well in that it has a system of incentives built in to it, i.e. better or more sophisticated risk management has the payoff of capital requirements more closely reflecting the internal view of risk. The trade-off for moving from Standardised to IRB is the meeting of threshold conditions to internal risk-weighting, reflecting the need for banks to have the resources, data and capacity (financial, intellectual and technological) to undertake meaningful risk modelling of their exposures. The use of the IRB Approach depends on prior validation of a bank's internal analysis by the national supervisor followed by on-going review and assessment of the firm's compliance with the IRB requirements. All other things being equal, for the same risk level and provided the external ratings are accurate, the IRB Approach results in lower risk weights than those calculated under the Standardised Approach.

The choice of the applicable regulatory approach depends mainly on the level of sophistication of the credit institution. The IRB Approach places stringent demands on banks' ability to evaluate, stress test and judge credit risk, which necessitates access to extensive and granular

⁹ In its December 2010 paper "Results of the comprehensive quantitative impact study", the Basel Committee on Banking Supervision estimated that the banks in its sample had a shortfall of stable funding of €2.89 trillion at the end of 2009. See <http://www.bis.org/publ/bcbs186.pdf>

data, highly skilled internal staff and sophisticated internal methodologies. This sets a high barrier to entry to the IRB Approach. That barrier is necessary to ensure that internal modelling is robust enough to be a reliable basis for assessing credit risk for regulatory purposes.

Small banking institutions, or those whose risk profile and activities are more straightforward, will generally be unable to justify the development of internal systems applicable to the full breadth of rated assets they currently hold, and, as a result, general restrictions on the use of credit ratings may cause such institutions to exit certain asset classes entirely. This will reduce funding available to help Europe's recovery from recession in the coming years and to enable Europe's banks to meet the new Basel 3 stable funding ratios. Moreover, for firms, the costs of building the necessary infrastructure to apply IRB standards to all assets would be time-consuming and expensive. In cases where the cost of applying internal modelling is disproportionate, access to CRAs' specialist expertise offers a more efficient and proportionate solution. Furthermore, for certain classes of asset there will not be sufficient data available to allow for reliable internal modelling of credit risk by less sophisticated firms. Many firms see this ability to leverage CRA knowledge as an efficient form of outsourcing the significant (and resource intensive) activities associated with, for example, sovereign ratings.

The added expense for both large and small firms may dampen their interest in markets affected by any revised prudential standards. This reduction in demand would reduce liquidity for a variety of instruments, and consequently would also reduce the extent to which these instruments could be issued to provide funding, to diversify and hedge risk and to comply with new stable funding ratios prescribed by Basel 3.

From the point of view of an investor seeking to invest in a bank, if all banks were forced to replace external ratings with their own internal assessments for some or all asset classes, then without material improvements to disclosure of asset data it is very possible that investors could view banks who were new to this approach sceptically. The result could be that those banks could then find it more difficult to raise funding due to a lack of investor confidence in their internal models. Investors will need to be confident that the issuers of any instruments in which they invest have adequate capital resources and a transparent risk profile, and will not generally be in a position to assess the quality of banks' internal models; nor will they necessarily be content to rely upon regulators to do so effectively. This could well result in investors concentrating on larger, more sophisticated banks who are familiar with and perceived to be more competent to apply the IRB Approach, with funding being diverted away from instruments issued by smaller banks. Lastly, a full prohibition on the use of credit ratings would negatively affect the

transparency of the capital adequacy guidelines, heightening the cost of supervisory review.

If there are to be any new future restrictions on the ability of firms to use the Standardised Approach these should (as with the current process for determining eligibility for the IRB Approach) be a matter for national regulators, and should be assessed on a case-by-case basis taking into account factors including, *inter alia*, the size and sophistication of the entity in question, rather than mandating widespread use of the IRB Approach in cases where firms may not have sufficient resources, expertise or data to implement and apply it robustly. For smaller firms in particular, external ratings are an efficient means of gaining access to the concentrated resources and professional expertise of CRAs, whose analysis will inevitably be more extensive and granular than those of all but the most sophisticated firms. This should be particularly so in light of the minimum quality standards for CRAs imposed by the new CRA Regulation, which should mitigate any risks arising from (non-exclusive) reliance by firms on external ratings.

Lastly, if a decision is made to mandate or encourage more widespread use of the IRB Approach in future, then the authorities should seek to ensure that standards for validation by national supervisors are implemented and applied consistently at a European level. Currently, there is scope for significant divergence between national regulators, making consistent judgement difficult for both banks and investors.

Use of ratings by IRB banks

Banks which are on the IRB Approach may nonetheless utilise external ratings as a basis for assessing capital. This is the case under the Ratings Based Approach to risk-weighting securitisation, where the CRD requires assessment of credit risk against ratings in securitisation positions.

IRB banks may also rely on external ratings in respect of "low default" assets in their portfolios for which it is not viable for them to create full internal analyses, due to the lack of internal historical data. This includes cases where a high level of qualitative analysis is required, which may not be purely financial/economic –as with sovereigns, for example. Where this is the case, using internal ratings would be misleading and potentially dangerous. It is hard to see what better proxy there is for credit risk than external ratings in these cases. External credit ratings are also used more widely for benchmarking purposes.

In conclusion, we believe that the use of standardised approaches to risk weight should continue to be allowed in cases where the relevant institution has determined that it is more appropriate, in light of its

business profile, resources, data and capacity not to undertake detailed internal risk modelling of exposures.

(2) How do you assess the reliability of internal models/ratings? If negatively, what could be done to improve them?

The global validation of the IRB Approach by the Basel Committee and European authorities would appear to deem existing internal models to be a "reliable" mechanism for internal modelling of credit quality – if applied and implemented properly. However, to assess the reliability of this approach in practice is more challenging, since any judgement of "reliability" necessitates a comparison of past internal ratings against historical default rates. The limited data available for internal ratings means that this is a very difficult task. Where firms do perform back-testing exercises to assess the accuracy of internal data, this in any case would involve benchmarking the data against external ratings in order to measure the relative "accuracy" of internal models.

Even for firms that do run their own internal ratings, external CRA ratings are nevertheless a useful reference point because internal ratings come from inside the "Chinese wall". Given that firms need access to ratings for the public side of their businesses, in order to continue to respect their internal governance rules and comply with relevant regulations on the use of private and public information, they will continue to be significant users of external CRA ratings in these public areas of their businesses.

(3) Do you agree that the requirement to use at least two external ratings for calculating capital requirements could reduce the reliance on ratings and would improve the accuracy of the regulatory capital calculation?

Use of two ratings where available is good practice and is already embedded within the Basel framework, with risk weightings being based on the less favourable of the two ratings¹⁰. However, an absolute requirement for at least two ratings in every case will remove the ability of firms to risk-weight credits for which only one rating is available or even feasible, a matter which will often be outside of their control given prevailing engagement arrangements. This would reduce risk-sensitivity of the system, increase costs overall, and discriminate in regulatory capital terms against borrowers in those Member States with less well developed ratings industries.

In any case, a single rating should be a sufficiently reliable indicator of credit quality in the context of the future regulatory environment, in which all ratings used for regulatory purposes may only be provided

¹⁰ Generally, see Section 1 of Part 3 of Annex VI of the CRD: with respect to securitisation, see Section 2 of Part 3 of Annex IX of the CRD.

by authorised CRAs whose assessment processes and methodologies have been approved by ESMA.

It is also difficult to see how mandating use of dual ratings would reduce reliance on ratings *per se* (though it would reduce reliance on a single indicator) or the potential for cliff effects. There is also no reason to suppose that reliance on two ratings would result in improved accuracy of credit assessment in practice. The current US and European prudential rules (which were in place before the crisis) required choice of two or more external ratings in some instances but did not always prove to provide better indicators of future performance. Historically, ratings have tended to cluster together within a narrow range; we are not aware of many cases where rating agencies have differed significantly and materially in the ratings attributed to different issuers or structures.

The implication in the draft Klinz report that the second rating issued by a CRA would be selected by ESMA "on the basis of merit, taking into account historic performance"¹¹ only serves to highlight the facts that, firstly, the accuracy of ratings can only be determined over time and secondly that they can only be measured relative to the respective methodology being used.

It also seems unlikely that the practice of relying upon the lower of two ratings would significantly reduce cliff effects, since a single downgrade would probably be sufficient to capture rating triggers in many investment mandates and/or induce conservative investors to liquidate the assets.

Finally, with regard to performance and ratings migration data, we refer the Commission to the AFME website at [://www.afme.eu/document.aspx?id=4084](http://www.afme.eu/document.aspx?id=4084) which shows, in the context of structured finance (one of the most stressed sectors through the financial crisis) that ratings migration has in fact been considerably less than is often supposed.

(4) What alternative measures of credit risk could be used in regulatory capital frameworks? What are the pros and cons of market based risk measures (such as bond prices, CDS spreads) compared to external credit ratings? How could pro-cyclical effects be mitigated if market prices were used as alternative measures of credit risk in regulatory capital regimes?

Market based risk measures such as CDS and bond spreads are available on a limited pool of credits and so would in any case only offer a partial solution. They would potentially result in separate methodologies: one for calculating capital requirements in relation to names with market/public data, and another for those without. Nor

¹¹DRAFT REPORT on credit rating agencies: future perspectives (2010/XXXX(INI))
Committee on Economic and Monetary Affairs/Wolf Klinz , p.6

are CDS and bond spreads an effective indicator of credit risk; pricing reflects other factors such as market risk, liquidity risk and counterparty risk, as well as general sentiment towards a market sector or even investment generally.

Recent research by Fitch ratings¹² illustrates the tendency of CDS spreads to generate false positives (i.e. PD of 100% or more) during times of stress, which could lead to overestimation of eventual realised losses. This would undermine the robustness of risk-weightings based upon CDS spreads, and have negative effects for stability if embedded in the risk-weighting framework. The research is mainly US focused – though this only serves to highlight the lack of available CDS spread data in the European market, which reinforces our point that it is a questionable universal substitute as a credit risk indicator.

Market indicators are inherently more unstable and sensitive to intra-day volatility. The cliff effects that could materialise based on the collective response of investors where capital charges are tied to market-based measures would heighten instability and exacerbate procyclicality of capital, by resulting in capital releases when the market is overly bullish and exacerbating downward pressure in a downturn scenario. Accordingly, requiring use of market-based measures or other alternative benchmarks for regulatory purposes would replace reliance by market participants on one source with reliance on another, more volatile and, in our view less appropriate, benchmark.

In practice, firms' internal risk management processes will already take into account market risk and liquidity concerns in addition to credit ratings in assessing risk and making investment decisions. It should also be noted that CRAs are now also modifying their methodologies to reflect market inputs (either at rating inception or during the life of the asset).

It is difficult to see what other alternatives to credit ratings would provide an equally appropriate stable and risk-sensitive indicator of credit quality, taking into account the characteristics of the particular instrument in question. Replacing credit risk with risk weighted categories based purely on asset class, for example, (as suggested by the US agencies as a part of the Dodd Frank reform proposals) would focus disproportionately on structure and not allow timely and accurate measurement of changes in credit quality (in particular credit risk associated with a particular issuer). This would discourage more analytical, sophisticated differentiation of risk. In some ways it might be seen as a return to the less sophisticated approach of the Basel 1 Accord.

¹² "CDS Spreads and Default Risk - Interpreting the Signals" – Fitch Ratings, October 12 2010

- (5) Would it be appropriate to restrict institutions'/insurance or reinsurance undertakings' investment only to those securitisation positions for which capital requirements can be reliably assessed? To what extent could the requirement to internally rate all or at least most underlying exposures restrict the potential investor base for securitisations?**

There seems little doubt that it is appropriate to ensure that institutions should only purchase assets for which capital requirements can be reliably assessed. However, the consultation implies that reliable assessment of capital requirements can only be made by an investor where it is able to internally rate the underlying exposures. This implication is wrong in our view: we believe the use of credit ratings, combined with the exercise of independent analysis and judgement, is a sufficient basis for reliable assessment of capital requirements.

Limiting investment in securitisation to circumstances where the investor can rate all assets in the underlying pool would effectively amount to abolition of rating reliance, not mitigation of overreliance. This would further dissuade investors from participating in securitisation funding by presenting serious practical problems. The systems and processes required to undertake the necessary analysis will not be feasible for most market participants. In particular, it will be necessary to develop sophisticated internal models and data handling capabilities which will not be cost effective for most investors. In general, the analysis involved would be difficult, labour- and technology-intensive, of little interest to all but a few investors and add little to the quality of a credit assessment of a large and diversified pool of underlying exposures.

As far as trading and liquidity are concerned, additional requirements would be particularly problematic where securitisation positions are acquired for trading purposes rather than with a view to the relevant positions being held to maturity – where the level of internal work required to rate such assets would be disproportionate in view of the risk incurred and the dynamic nature of both the trading book positions and the underlying portfolios. This would have very serious negative implications for the liquidity of the securitisation market. The ECB, among many other investing and funding institutions, is keen for liquidity to return to the securitisation market, not to see it further restricted.

Disclosure of underlying loan-level data is necessary for investors to be in a position to rate the underlying exposures. While there is a move towards the disclosure of loan-level data in certain segments of the ABS market as a result of the new disclosure and reporting requirements introduced by the ECB and the Bank of England for (inter alia) RMBS as part of their eligible collateral frameworks (which requirements are supported by our members), significant work

remains to be done with respect to the implementation of these initiatives and the details of the requirements to be introduced for other types of ABS are not yet known. The implementation work will include addressing potentially difficult issues such as confidentiality (where the underlying exposures are corporate loans) and also data protection and bank confidentiality considerations (where the underlying exposures are residential mortgages, consumer loans or other consumer assets). Some progress has been made in addressing these issues in the UK, although work remains to be done in the UK and elsewhere in Europe. In addition, practical issues arise in the context of deals involving highly granular and/or revolving assets and these issues have been acknowledged by the ECB and also by CEBS in its recent guidance on CRD2.

It should also be noted that recent regulatory initiatives – such as the investor due diligence requirements imposed by CRD2 – will help ensure that appropriate analysis is undertaken by investors with respect to the underlying exposures. It is not clear that further requirements are necessary or justified, especially considering that the CRD2 requirements only took effect at the start of January and that the full implications of the requirements on current ABS investor due diligence practices are not yet known. In the interests of supporting the revival of the securitisation market and encouraging more investors to participate, we encourage the Commission to consider very carefully the current fragility of the market and the strong policy objective of making it easier, not more difficult, to raise funding to aid Europe's recovery before imposing any further burdensome requirements on existing and potential investors.

We believe strongly that imposing a requirement on investors to internally rate all or most underlying exposures will incentivise the relatively few remaining ABS investors to exit the market, and disincentivise any new potential investors from entering it. This is precisely the opposite policy objective that we believe is required as Europe struggles to recover from recession. In general, a reduction in the buyer base for securitisation would in turn mean a closure of a funding source for banks – a rationing of available funding could restrict credit availability and increase pricing to consumers. This could consequently damage securitisation markets with adverse effects for the real economy.

- (6) Can the existing "supervisory formula" based approach in the Capital Requirements Directive be considered to be sufficiently risk sensitive to become the standard for all securitisation capital requirements? If not, how could its risk sensitivity be improved without placing reliance on institutions' internal estimates other than default probability and loss for the underlying exposures? In the insurance sector, how do you assess the approach to credit risk for structured exposures used in QIS 5?**

In our view, the current supervisory formula is risk sensitive (albeit relatively conservative), but requires highly detailed analysis of all underlying exposures in the pool. This imposes significant data and resource demands on firms, which are disproportionate for smaller or less sophisticated firms or for trading book holdings, as discussed in Question 5 above. It would not be appropriate for it to become the standard for all securitisation capital requirements.

Firms should be allowed to consider 'standardised' inputs where it is not practicable to apply the supervisory formula approach. We would recommend consideration is given to the development of a simplified approach which firms can use when the data on the underlying pool is not available.

Regarding QIS5, while we believe that firms need to understand their risk exposure to securitised assets we will be interested to see firms reactions in QIS5 as the use of the greater of the capital based on the rating of the instruments and the capital based on the underlying assets appears to impose a heavy burden where the exposure is limited and for smaller firms.

Questions 7-11:

(7) Should firms be explicitly obliged to carry out their own due diligence and to have internal risk management processes in place which do not exclusively rely on external ratings?

It is consistent with existing legal and regulatory requirements to have due diligence and internal risk management processes and not to rely solely on ratings. We are not aware of any firm which invests in debt solely in reliance on ratings.

The European regulatory framework contains high level requirements applicable to regulated institutions requiring high standards of risk management (eg Annex V of Directive 2006/48/EC (credit institutions), Article 7 of Directive 2006/73/EC (investment firms), Article 51 of Directive 2009/65/EC (UCITS management companies). The Alternative Investment Fund Management Directive also sets out high level risk management requirements. Further, investment managers also have fiduciary obligations to their clients under the general law. These requirements impose regulatory and legal obligations on firms which go beyond (in that they would not be satisfied by) mere reliance on ratings.

In addition, as noted in response to Question 5, new investor due diligence requirements for securitisation positions now apply under CRD2 with respect to banks, and provision has been made for equivalent rules to follow for other regulated entities (including UCITS, AIFMs and insurance and reinsurance undertakings). The benefit of these requirements is unproven given their implementation

date. Moreover, it is not clear that the requirements present a good model for regulatory obligations more generally as suggested by the question.

To require comparable levels of investor due diligence for corporate and/or sovereign ratings, as in structured finance, would be inappropriate given the different capital and business structures of issuers, and the fact that access to appropriately standardised data may be unavailable or unduly difficult to obtain relative to structured finance transactions. Structured finance instruments are inherently more quantitatively driven than corporate or sovereign ratings, which require more qualitative assessment.

For sovereign ratings in particular, qualitative analysis of political and other non-financial variables may be necessary in order to assess the risk associated with these credits. Most firms will not have internal analysts with a high degree of specialist expertise on these rated entities, but will nonetheless be able to make an appropriately informed independent judgement on the risk associated with these asset classes by taking into account, while not relying exclusively on, third party CRA analysis.

To the extent that any mandatory due diligence standards are introduced, a prescriptive set of requirements is likely to reduce access to certain financial markets for less sophisticated investors who are unable to meet these requirements, particularly if breach of the standards is accompanied by penal capital charges or other sanctions for non-compliance, as in the case of securitisations under the new CRD2 requirements. Once again, there is a significant risk of driving investors away. Any requirements should be expressed at a sufficiently high level to allow for flexible implementation depending on the nature and scale of the business of the firm and the characteristics of the issuer and of the instrument in question.

A requirement for firms to justify the extent to which external ratings have been relied upon or supplemented with internal assessment would be more proportionate and effective than mandating widespread use of minimum due diligence standards. Greater reliance should be possible in relation to asset classes where credit ratings have proved to be reliable and suitable. For more complex, illiquid assets, firms could be expected to supplement or substitute external ratings with more extensive additional input and internal (or other third party) default analysis.

Any new requirements should be guided by the need for proportionality in the implementation of the requirement relative to the function performed by, and nature, scale and activities of, individual institutions. Implementation should be phased in over an appropriate period due to the costs and development time involved,

but also to ensure credibility and market confidence in the new approach.

If specific internal due diligence standards are prescribed even for firms using the standardised approach, one question in this context would be whether the result of this additional diligence would be one-way only (i.e. allow only a worse internal assessment to be used, compared with an external rating) (which is implied by paragraph 1.1(5) of the Consultation Paper), or both-ways (i.e. allow a better or a worse internal assessment to be used compared with an external rating). If the former, this could lead to tokenistic application of the additional requirements by firms, since there would be little incentive to conduct robust due diligence where this could only result in higher capital requirements. The regulatory framework should incentivise informed internal risk management processes via the possibility of lower risk weightings, but only in cases where the integrity of risk weightings is supported by the means to conduct diligence effectively.

(8) What information should be disclosed to supervisors in order to enable them to monitor the internal risk management processes of firms with particular focus on the use of external credit ratings in these processes?

Ensuring that firms have effective risk management processes to enable them to monitor and address risks associated with externally-rated exposures is not primarily a question of disclosure, but of creating effective regulatory incentives to improve internal risk management. However, national supervisors generally have powers to require any information they see fit in relation to the applicable prescribed minimum standards for management of risk-weighted assets. Supervisors should challenge firms in relation to their risk management in the ordinary course of supervision: practice is more important than disclosure documentation in this area. The supervisory authorities are best placed to comment on the exhaustiveness and appropriateness of the information provided to them.

(9) To what extent do firms currently use credit risk models for their internal risk management? Are the boards of directors or other governing bodies of these firms involved in the review of the use of credit ratings in their investment policies, risk management processes and in investment mandates?

The AFME and BBA membership includes a diverse range of institutions. Different firms have different approaches across different businesses and asset classes. The more sophisticated firms make use of full internal capital modelling that even goes beyond the IRB approach and includes firms' own correlation assessments in relation to risk weighted assets. However, there are relatively few firms with the resources and skills to do this.

For banks and investment banks, the process of delegating authority to lend, invest or trade from board down to credit committees is a well established practice. The board or governing body would typically approve an overall strategy but delegate day-to-day implementation of that strategy to other senior executives (below, but ultimately reporting to, the board). Considerable analysis would typically be undertaken by such executives and their teams as part of any lending or investment decision, and this might include the use of credit risk models (for example, in structured finance) or not (for example, in sovereign finance or other lending where a more qualitative approach was appropriate). This is fundamentally how lending and investment decisions are made, is embedded in Basel and validated by the regulator. There are differences in detail between the policies and process associated with credit risk in the trading and non-trading books, but the principles underpinning the policies and processes are similar.

Other classes of market participant, such as insurers and asset managers, have analogous controls (albeit that investment managers' policies and procedures apply with respect to credit risk taken on behalf of their clients).

(10) What further measures, in addition to the disclosure proposals included in Articles 8a and 8b of the proposal amending the current CRA Regulation could be envisaged?

We note that Articles 8a and 8b have been removed from the final package of amendments to the CRA Regulation adopted by the EU authorities on 15 December 2010. Recital 5 to the text refers to further work to be done by the Commission with respect to the transparency of information underlying ratings of financial instruments and indicates that this should take into account the impact on the local securitisation markets, other regulatory developments and the experience gained by regulators in other jurisdictions. We support this move and the need for further consideration of issues related to information transparency. As indicated in previous materials submitted by AFME to the Commission, our membership considers that the adoption of new disclosure requirements modelled on US Rule 17g-5 raises significant issues. Even if the legal issues surrounding data protection can be overcome, corporates are unlikely to be willing to share confidential information (for example, projections, etc) to agencies they cannot control. The introduction of disclosure requirements of the type under consideration would likely result in rating agencies being likened to fixed income research houses, which would remove some of their value, somewhat undermining their intrinsic competencies. There would also be significant compliance challenges for CRAs and issuers presented by the adoption by European authorities of requirements inconsistent with Rule 17g-5.

Outside the structured finance context, the CRA Regulation already contains extensive disclosure obligations for CRAs, which go beyond the requirements of the IOSCO Code¹³ in prescribing specific information that must be disclosed for individual ratings. These requirements are nevertheless sufficiently high-level to preserve an appropriate degree of flexibility for other rating categories. It would not be appropriate to seek to introduce requirements such as Article 8a and 8b in the context of sovereign or corporate ratings, given the more subjective nature of the analysis undertaken by CRAs in respect of these categories and the greater divergence across methodologies.

For investors relatively extensive data is already publicly available in relation to sovereign and listed corporate issuers; the challenge for investors is having internal models to harness and analyse this data effectively. To the extent that information is not widely available to investors, market forces will require disclosure of information where necessary to support the diligence requirements (e.g. loan-level or enhanced structural data on structured finance instruments). Any further regulatory prescriptions on specific periodic or trigger-based disclosures by CRAs could result in unintended cliff effects in response to such disclosures, particularly if timing is not carefully managed.

(11) Would you agree with the assessment that sovereign debt ratings are primarily based on publicly available data, implying that rating agencies do not have advanced knowledge? Do you consider that all financial firms would be able to internally assess the credit risk of sovereign debt?

We would agree that it is largely correct that ratings of sovereign debt are based mainly on publicly available data¹⁴. However, this does not alter the fact that collection and analysis of this data for credit rating purposes is a specialised field in which only some banks could perform assessments. Obtaining reliable, consistent data, which is comparable across sovereigns and in an accessible form for analysis purposes, is a challenging process. The level of specialist input and effort required to collect, standardise and benchmark this data is highly resource-intensive (particularly given differences in languages, accounting standards and presentation of data). As a result, even banks or investors that conduct their own analysis of sovereign debt would often rely on data compiled by external CRAs to feed this analysis.

The fact that sovereign debt has historically been a low-default portfolio also presents difficulties for firms in conducting a reliable assessment under the IRB Approach, as firms have few data points upon which to base their modelling processes – hence many IRB firms

¹³ IOSCO Code of Conduct Fundamentals for Credit Rating Agencies, revised May 2008

¹⁴ The IMF Report comments (page xiii) that, “... recent changes in types of risks taken on by sovereigns ... imply that better publicly available sovereign risk information would be helpful to rating agencies and investors”.

will rely at least to some extent on input from CRAs in risk weighting sovereign assets.

We query what the value to the market would be of requiring all firms to attempt essentially to replicate the methodologies of external CRAs. We believe this could result in more variable and volatile assessments due to the lack of enough data on defaults, most firms' historic inexperience in this field and the difficulty in recruiting appropriately qualified analysts in such a specialised area.

Questions 12-15:

(12) Should there be a "flexibility clause" in investment mandates and policies which would allow investment managers to temporarily deviate from external rating thresholds (e.g. by keeping assets for a limited time period after a downgrading)?

It is important to distinguish between regulated investors (eg UCITS) and unregulated investors (eg UK pension funds).

Regulated funds (such as UCITS and other retail mutual funds) are typically regulated in respect of the quality of their assets. Whilst the European regulatory framework does not contemplate limits on investment mandates offered by regulated funds by reference to external credit ratings, ratings are commonly embedded in debt and money market funds as a contractual matter. Where these are not required as a matter of regulation there would be no regulatory impediment to flexibility clauses.

Unregulated funds have no relevant regulatory restrictions on investment powers and flexibility clauses can be put into mandates by contract. In practice, investment managers would often consult clients on the best course of action for a security following a downgrade or other trigger event – which may be to continue to hold rather than immediately liquidate, though managers may often still decide to sell immediately to avoid a potential larger loss later.

Clients should as far as possible have the ability to set investment mandates with reference to the risk parameters which they are willing to accept: this in itself provides an independent, third party assessment of risk to be applied by investment managers in managing credit risk across portfolios. The extent to which investment managers will deviate from external rating thresholds will depend upon the sophistication and risk appetite of the client, and will be less in the case of more conservative or less sophisticated investors, given the risk of liability for investment managers even where flexibility exists at a contractual level.

In practice it is clients that dictate the existence/application of flexibility clauses. Such clauses should be voluntarily assumed by managers and clients rather than imposed by regulation: to do

otherwise will be likely to be ineffective, as clients will be able to circumvent them contractually or behaviourally.

(13) Should investment managers be obliged to introduce measures to ensure that the proportion of portfolios that is solely reliant on external credit ratings is limited? If yes, what limitations could be considered appropriate? Should such limitation be phased in over time?

We do not believe such a criterion should be imposed. The manager should be able to take its own credit view and be remunerated for that responsibility. In practice, investment managers do not and will never solely rely on external credit ratings, since market practice dictates that clients will expect at least some degree of independent analysis of their investments. Portfolio monitoring by investment managers will typically consider external ratings in conjunction with guidelines on portfolio diversification and composition, concentration risk, market and liquidity risk, and overall capital and liquidity thresholds and general macro economic factors.

As noted in our response to Questions 5 and 7, the European regulatory framework includes high level requirements applicable to regulated institutions requiring high standards of risk management. In addition, new investor due diligence requirements for securitisation positions are proposed for UCITS managers and AIFMs. These requirements are targeted at ensuring investment managers apply appropriate risk management measures: it is not clear that further regulation is necessary with respect to such managers at this time and, in particular, in the absence of certainty as to the full corrective effect of other recent reform initiatives. Further clarification is also requested here on how the proportion of portfolios on which reliance upon external ratings is permitted would be defined, since any applicable thresholds could simply lead to more rigorous scrutiny of the simpler, more transparent holdings, and less rigorous analysis of the more opaque, difficult ones. This could create perverse incentives.

(14) What alternative measures of credit risk could be used to define the minimum standard of credit quality for a portfolio? Are rolling averages of bond prices/CDS spreads a suitable risk measure for this purpose?

Please see the answer to Question 4. We believe that regulators should not intervene in commercial agreements as to investment objectives, particularly in the absence of any appropriate alternative measures of credit quality. As noted above, investment managers would often have regard to market-based measures such as average CDS/bond spreads, but in addition to rather than instead of external ratings, which are a more reliable indicator of credit risk. CDS/bond spreads will reflect liquidity and market risk factors in addition to credit risk, and will be more inherently unstable and procyclical than credit ratings. Any effort to regulate the terms of investment

mandates along the alternative lines suggested might drive credit investment management outside the European Union.

(15) What other solutions could be promoted in order to limit references to external credit ratings in investment policies and mandates?

Please see the answer to Question 13. In principle, we believe that encouraging managers to obtain the flexibility in their mandates to deal with the situation as their best judgment suggests, rather than automatically being forced to sell, is the most practical and appropriate approach. Regulation would not be appropriate and would not achieve this objective.

Questions 16-18:

(16) What is your opinion regarding the ideas outlined above? How can the transparency and monitoring of sovereign debt ratings be improved?

We believe that the current approach works well and that the CRAs' ratings reports are generally sufficiently detailed and transparent.

The CRA Regulation imposes minimum competency standards for production and disclosure of sovereign ratings (as with all asset classes). Regulators should be responsible for providing further clarity on these standards and transparently assessing CRAs against them. Monitoring and enforcement by ESMA and by national regulators under the new regulatory framework should be sufficient to enable this to process to be effective. It seems premature to presume that "improvement" will be needed to a framework that has yet to be fully implemented and is in itself designed to improve transparency and monitoring in relation to ratings generally, including sovereign ratings.

Some further specific measures designed to increase transparency with respect to sovereign ratings may be appropriate, but should be balanced carefully against the potential for market distortion and increased conflicts of interest.

(17) Should sovereign debt ratings be reviewed more frequently? If so, what maximum time period do you consider to be appropriate and why? What could be the expected costs associated with an increase of the review frequency?

We believe that monitoring of a rating need only occur more frequently in crisis situations or event driven issues, where it may be necessary to reflect the frequency of new information coming to light in relation to distressed sovereign issuers and ensure that ratings remain accurate and that any ratings actions are published on a timely

basis. If the situation is normal, a one year review period should suffice.

- (18) Which could be the advantages and disadvantages of informing the relevant countries three days ahead of the publication of a sovereign debt rating? How could the risk of market abuse be mitigated if such a measure were to be introduced?**

Moving to a 3 day (rather than 12 hour) period for sovereigns to comment on ratings exacerbates the potential for undue influence on agencies' opinions by sovereign issuers. The opportunity to correct "factual" errors has the potential to encourage sovereign issuers to dissuade CRAs from relying upon certain adverse facts or otherwise influence the content and presentation of ratings, particularly since sovereign ratings are not purely factual and incorporate a degree of subjective judgement. Instead, individual Member States should be incentivised to pre-empt the risk of factual errors by improving the accuracy and transparency of information disclosed publicly and/or to CRAs, where such information could have a material impact upon sovereign creditworthiness.

A 3 day period also materially increases the risk of market abuse. We believe that this increase is not justified given the capacity for sovereigns to correct errors within a shorter time. The increased risk of market abuse associated with a longer period between rating and disclosure can only be mitigated by better control of information and effective procedures to monitor and penalise market abuse, both within sovereigns and CRAs. However, CRAs and sovereigns typically already have policies and procedures in place to minimise the risk of market abuse today. Such policies and procedures mitigate but will not eliminate the risk of market abuse. The effectiveness of such measures is unlikely to be improved by additional regulation.

Questions 19-22:

- (19) What is your opinion on the need to introduce one or more of the proposed measures?**

CRAs already disclose the assumptions, parameters, etc., underpinning their sovereign rating methodologies, and hold regular discussions to explain and discuss their methodologies. Exact replication of the disclosure standards applicable to structured finance instruments under the CRA Regulation would not be appropriate in the context of sovereign ratings, for the reasons discussed in Question 10.

- (20) More specifically, could a rule, according to which credit ratings on sovereign debt would be published after the close of business of European trading venues be useful? Could such a rule be extended to all categories of ratings?**

We do not believe that publishing results after the close of business of European trading venues would mitigate the risk of leaks to non-insiders, or reduce instability, since other markets will be open at the time of rating publication. The foreign exchange markets, in particular, operate 24 hours a day.

Delay would increase risks of market abuse. It would also place local firms at a disadvantage as they would be adversely affected in terms of their ability to take action by publication being delayed until after close of business. For non-EU firms who may not have access to European analysts at the time of publication, the new rule could also result in market volatility where market participants make immediate and insufficiently informed decisions.

(21) Could a commitment of EU Member States not to pay for the evaluation by credit rating agencies reduce potential conflicts of interest?

Prohibiting the "issuer-pays" structure for Member States would reduce potential conflicts of interests for CRAs in rating Member States. However we see no reason to differentiate sovereigns from other rated entities, since, as with the "issuer-pays" model generally, the priority should be to ensure that conflicts are managed effectively. If those conflicts are managed (as they should be), then there is no reason to exempt Member States from the obligation to pay for ratings.

In principle we would not object to alternatives to the "issuer-pays" model, provided that appropriate safeguards are also in place to manage conflicts in these models. However, in the absence of a well-developed "investor pays" market in Europe, it is difficult to see how sovereign debt ratings would be sufficiently well funded, if not by issuers – particularly given the wide-ranging and resource-intensive process needed to produce a robust sovereign debt rating. One alternative model you have asked us to consider has been to establish an EU-funded sovereign rating entity, to which all Member States could contribute. This could reduce the current disparity whereby only some Member States pay for ratings; we note, however, that consensus at a global level would be necessary for this model to work effectively and independently, in ensuring transparency and integrity of the CRA selection arrangements and the resulting ratings process. In the absence of a global framework for sovereign ratings, however, we note that it is open to the EU to implement requirements for consistent arrangements across Member States regarding payment for sovereign ratings, without altering the nature of external CRAs' business models.

(22) What other measures could be considered in order to enhance investors' understanding of a sovereign debt rating action?

The challenge for sovereign debt investors is not so much a lack of understanding as the difficulty in ensuring a consistent approach to a market where political and other subjective factors play such an important role in setting quantitative credit quality benchmarks.

Questions 23-30:

(23) How could new players be encouraged to enter the credit rating agency sector?

We support the Commission's objectives in ensuring a competitive market for credit ratings, but also endorse the comment on p.19 of the Consultation Paper that measures introduced to enhance competition should not distort the market or lead to a decrease in quality of rating. We are concerned that most of the measures proposed in the Consultation Paper as suggestions for stimulating competition have the potential to result in one or both of these consequences.

Whilst the sector is dominated by the top three CRAs, many other agencies already exist, and there are incentives for both larger and smaller players to compete. Increasing the number further will not necessarily increase quality, but could have the opposite effect if new players are encouraged to enter the market without being supported by sufficient resources and expertise. This could also encourage 'rating shopping' by market participants. It should also be borne in mind that fragmentation of the industry would result in increased burdens for issuers, as they would have to invest resource in dealing with a larger number of relationships with CRAs.

As far as barriers to entry are concerned, there is no doubt that establishing and maintaining a successful CRA is an extremely resource-intensive operation, particularly where sovereign, corporate and structured ratings are to be provided on a cross-jurisdictional basis. Even CRAs operating within niche markets need to be able to build sufficient specialist expertise and well-developed methodologies in order to offer users a service whose quality rivals that of the larger CRAs in these areas.

We support the creation of appropriate incentives for new players to enter the sector, which could include reduced barriers to entry, but at the same time it must be acknowledged that the current regulatory environment presents undeniable challenges and risks to both new and existing CRAs, whose future appears progressively uncertain. Since reliance on external ratings is ostensibly to be reduced, both in Europe and in the US, this could lead to shrinkage of the market overall, as could any future prescriptions or prohibitions on acceptable forms of business model, or additional liabilities imposed by new legal regimes. Even absent any further reforms, future participants in the sector will also face increasing barriers to entry in the form of the registration criteria and overall regulatory burden imposed by the CRA Regulation. A balance is needed between setting

acceptable minimum standards for improved quality and transparency within the sector, and placing compliance and/or cost-based barriers to entry so high that only a small number of CRAs are able to compete.

- (24) Could it be useful to explore ways in which the ECB would provide ratings to be used for regulatory purposes by European financial institutions? If yes, which asset classes (corporate, sovereign, structured finance instruments etc) could be considered?**

Entrusting the ECB with the task of providing ratings to be used for regulatory purposes risks competitive distortions. It also raises significant concerns over conflicts of interest given the ECB's involvement in determining the eligibility of rated assets as collateral for ECB liquidity facilities – the criteria for which refer to satisfaction of certain high credit standards which may be met via certain minimum credit ratings.

There is a clear risk of perceived conflicts of interest in the ECB or national central banks rating EU Member States, other publicly funded entities or corporates in receipt of state aid given the likelihood of support for distressed EU sovereigns. Central banks adopting ratings roles would face the same issues. Ultimately the test of perceived conflicts in this case would be assessed when a sovereign was in difficulty – in which case the ECB (or other central bank) would encounter the same challenges that existing CRAs do.

- (25) Could it be useful to explore ways in which EU National Central Banks would be encouraged to provide in-house credit rating services? Could the development of external credit rating services also be considered? If so, which asset classes (corporate, sovereign, structured finance instruments etc.) could be targeted? What are the potential advantages and disadvantages of this approach?**

Please see the comments above in relation to ECB ratings: similar issues in relation to conflicts of interest and competitive distortion would apply in the context of national central banks taking on rating functions.

- (26) Could it be useful to explore ways in which Member States could be encouraged to establish new credit rating agencies at national level? How could such agencies be structured and funded and what entities and products should they rate? What are the potential advantages and disadvantages of this approach?**

Please see the comments above in relation to Question 23. We believe that the EU should not act as a promoter of particular rating agencies or models, particularly where this could distort the market or compromise ratings quality. Encouraging greater proliferation of

national credit agencies risks both outcomes, due to the largely global reach of rated entities/products. To the extent that more localised or specialised products may be better served by localised or specialised CRAs, this should be determined by market demand rather than EU or state intervention.

(27) Is there a need to create a new independent European Credit Rating Agency? If so, how could it be structured and financed and what entities and products should it rate (corporate, sovereign, structured finance instruments)? Should it be mandatory for issuers to obtain ratings from such a credit rating agency? What are the potential advantages and disadvantages of this approach?

We do not believe that, based on current market conditions and practice following implementation of the CRA Regulation, a case has been made for an independent European CRA. We remind the Commission once more that the performance of credit ratings in Europe has been better and more stable than is often perceived: see for structured finance the AFME website¹⁵ and for sovereigns the IMF Report¹⁶.

Should such an agency be established, our industry does not consider it appropriate that it should be funded by CRAs or their users, particularly in view of the compliance costs already imposed on the sector (and its users) by the new and proposed regulatory measures.

On the other hand, use of public funding to create a European CRA would compromise the independence of the ratings process and divert resources away from ensuring effective implementation, monitoring and enforcement of the new regulatory framework for existing independent CRAs. Establishing a European CRA also poses a particular risk of competitive distortions and (if its ratings are widely adopted for regulatory purposes) greater cliff effects than where a spread of ratings is available.

Additionally, we note that each of the major agencies have significant presence in Europe with analytical and other professionals from various countries. Therefore, we are not convinced that the creation of a European CRA would add further benefit in terms of cross-jurisdictional expertise or other quality-enhancing input.

(28) Is further intervention needed to lower barriers to entry or expansion in the credit rating agency sector in general or as regards specific segments of the credit ratings business? What actions could be envisaged at EU and at Member State level?

¹⁵ Performance and ratings migration data for structured finance in Europe can be found on the AFME website at <http://www.afme.eu/document.aspx?id=4084>

¹⁶ <http://www.imf.org/external/pubs/ft/gfsr/2010/02/pdf/text.pdf>

Please see the answers to the questions above. The parallel moves to reduce overreliance on the sector and impose stringent new regulatory requirements on existing participants present challenges to any business plans for new or extended credit rating services. Incentives to enter the market should take a qualitative and non-pecuniary form and should not seek to favour particular business models. Greater certainty in regulatory terms, particularly in relation to any restrictions on business models and/or the purposes for which ratings may be used, would assist existing or potential rating agencies to innovate more effectively in entering the market or developing new forms of business model.

(29) Would the creation of a European Network of Small and Medium Sized Credit Rating Agencies help increase competition in the credit rating agency sector? What are the potential advantages and disadvantages of this approach?

We do not believe there is any significant demand in the market for a network of small and medium sized CRAs. We believe the proposal, if implemented, would artificially create more CRAs with the disadvantage of losing globally consistent benchmarks. Encouraging smaller or more narrowly-focused CRAs could compromise the quality of ratings assessment, particularly in relation to more complex products, due to the limited scope and analytical depth of such agencies; there are cross-product and cross-jurisdictional insights that would be lost and possibly weaken the analytical rigour underpinning the ratings process. Too much fragmentation could also reduce the distribution capability of individual CRAs, market depth and liquidity of rated instruments, which would benefit neither the sector nor its users.

(30) Do you consider that there are any further measures that could be adopted to enhance competition in the rating business?

Please see the comments above. As noted, while we do not consider that any specific further measures are necessary, we do believe that clear, transparent and proportionate regulatory standards would be positive steps to facilitate competition. In finalising the relevant standards, however (at least for the immediate future), we stress once again the importance for European authorities of ensuring that decisions be made bearing in mind firstly the need for existing regulation such as the CRA Regulation to be given time for its practical effect to be determined, secondly, the cumulative cost and compliance burden imposed to date and thirdly global consistency particularly with the US, to enable markets to function properly at a global level. This would be particularly true for European initiatives that would introduce significant changes to business models or otherwise fundamentally alter the structure of the European market.

Questions 31-33:

(31) Is there a possible need to introduce a common EU level principle of civil liability for credit rating agencies?

The significance of ratings to financial markets is such that market participants should be able to rely on CRAs to prepare and issue ratings according to a minimum level of due care and skill, in line with the standards reasonably expected of professionals in the business of issuing ratings. There need to be sufficient incentives for CRAs to adhere to this standard, which would be an appropriate general standard of care included in the CRA Regulation. These incentives may be provided by market forces, regulation and/or legal liability. We do not believe that this objective would be best achieved by introducing a common EU civil liability standard for CRAs. A liability standard would bring significant disadvantages without offering meaningful recourse for users of ratings. The CRA Regulation already provides a blueprint for the expected standards of professionals operating in the sector. Breaches of these regulatory standards will be better dealt with through effective enforcement action by regulators than by the threat of private action.

Parallels could be drawn with the audit profession. Auditors' pronouncements in relation to the financial health of entities are relied upon by a great many market participants, but they do not usually bear liability to third parties for their statements except in very limited specific circumstances. While CRAs also issue statements in relation to the financial strength of entities or instruments, CRAs' opinions as to creditworthiness are based on more subjective, qualitative judgements than those of auditors, and therefore lend themselves even less readily to private causes of action.

As an overarching principle, we do not believe that it is appropriate to tie liability to regulatory obligations. While civil liability for breach of certain statutory duties or other regulatory requirements exists to a greater or lesser extent under different national laws, other regulated financial practitioners do not generally bear the risk of civil liability for breach of any provision of the applicable regulatory framework. In the UK, for example, it would not be possible for an institutional investor to sue an investment firm for breach of an FSA rule.

We also would query the likelihood of consistent interpretation of any liability standard. Consistent implementation and enforcement of a civil liability regime for CRAs would be particularly challenging given the diversity of likely interpretational approaches taken by the courts in individual Member States. This in turn also raises the question of whether a consistent liability standard is achievable in practice: we believe not.

In the context of the proposals in section 3.1 of the consultation, we would question whether any of the public rating entities proposed

would be subject to the common liability standard; if established, they certainly should, in order to maintain a level playing field and incentivise equality of standards.

We have various concerns in relation to the introduction of a common civil liability standard, which can be summarised as follows:

(a) Legal implications

The extent to which third parties, that have suffered loss or other damage in connection with a CRA's failure to adhere to applicable professional standards, have recourse to redress currently varies between Member States. A minimum liability standard for CRAs could in principle reduce the incentives for forum shopping by CRAs; though in the absence of a maximum harmonisation regime there would still be scope for individual Member States to introduce super-equivalent requirements, which would perpetuate the current divergence in liability standards. In any case, we are not persuaded that forum shopping considerations are a determinative consideration for CRAs in establishing their geographical location(s).

More significantly, the different frameworks and judicial/interpretative conventions of applicable national laws would make it very difficult to implement a common civil liability standard that would be understood or applied consistently across Member States, given the extent to which concepts such as negligence will be interpreted by local courts.

Even within each individual Member State, it would be difficult to risk assess the practical impact of a civil liability regime, in view of the highly subjective and qualitative nature of ratings, and the challenge for market participants and courts of assessing, *inter alia*:

- (i) the standard by which CRAs are assessed: any duty of care owed by CRAs would presumably have to be assessed against prevailing good industry practice at the relevant time. To the extent that the industry as a whole had failed to take certain factors into account (as was the case in the lead-up to the financial crisis), and these are not required by regulation, presumably no liability would attach;
- (ii) whether a rating is "correct" or "appropriate": since ratings are forward-looking statements, this can only be judged retrospectively by benchmarking the rating against ratings issued by other CRAs over a period of time, and coming to a conclusion on the basis of this data as to the prevailing standards of "appropriateness". It would be difficult to award judgement to a claimant

for loss based on an "incorrect" rating before a certain period of time had elapsed;

- (iii) whether, if a rating is judged to be inappropriately high or low, to what this is attributable: a CRA may have failed to comply with a standard of care or particular provisions of the CRA Regulations, but it may be difficult to prove that this breach, and not other factors, led to the issuing of an incorrect rating. For example, the value of ratings to market participants often depends upon the timeliness with which a rating is reviewed in light of market developments, but since what amounts to adequately timely review will vary in each case, it would not usually be possible to point to a precise standard on this basis;
- (iv) whether a sufficient causal link exists between the regulatory breach and the loss or damage suffered by the claimant: an investor bringing an action against a CRA as a result of loss suffered due to securities being incorrectly rated would presumably have to prove that in making the decision to invest (or not invest) in the securities, sole or principal reliance was placed upon the external rating. This would call into question the extent to which this level of reliance was justifiable from the investor's perspective, which could potentially require courts to assess the extent to which the investor had fulfilled its own obligations (as to due diligence, etc) under the applicable legal and regulatory regimes.

(b) Financial implications

CRAs are generally not highly capitalised relative to the value of the securities they rate. A single successful claim by an investor or other user who it could be proved had suffered damage as a result of the CRA's "incorrect" rating could easily be sufficient to render the CRA insolvent – without necessarily enabling the claimant to be fully compensated for the loss suffered. In reality a liability standard therefore would not be effective in giving investors meaningful recourse for substandard rating practices.

A prudent CRA will take account of the additional risk introduced by a liability standard by insuring against it (if possible) and passing the costs of the premiums back to clients – or by self-insuring and pricing the additional risk into its service offering through higher fees or changes to its business model. The difficulty of quantifying the risk in financial terms due to the lack of legal certainty in enforcement of the standard and the lack of precedent elsewhere in professional practice would be likely to mean that the costs associated with pricing

the risk of liability into rating services would be significant, yet the excess may still not be sufficient to cover losses suffered by investors.

As noted above, the additional risks and costs associated with the threat of private damages actions following breach of regulatory standards would also create a further barrier to entry, which could deter new entrants to the market.

(c) Further market impact

As the Consultation Paper repeatedly acknowledges, it is vital that the regulatory environment in which CRAs operate is conducive to the exercise of independent judgement and makes effective provision for managing conflicts of interest. We are concerned that powerful institutional clients of CRAs could use the threat of high-value damages actions as a lever to induce CRAs not to downgrade securities or issuers, which could have a restrictive effect on the ability of CRAs to issue full and frank opinions of creditworthiness in a timely fashion. Further safeguards would need to be introduced to manage this increased risk of conflict of interest, thereby increasing the regulatory burden on CRAs (and potentially the costs to the market) yet further.

We would also query whether introduction of a legal liability standard might in fact encourage over-reliance and “box-ticking” by investors, which runs contrary to the policy goals of the Commission.

In conclusion, our view is that failure to adhere to professional/regulatory standards can be most successfully addressed by an effective regime of regulatory sanctions and transparent penalties. We note in this respect that the CRA Regulation, as amended, provides ESMA with the power to impose fines on CRAs where it finds that they have committed, intentionally or negligently, an infringement of the CRA Regulation, with the level of the fine in question being based on a combination of the CRA's turnover and the seriousness of the infringement. This provides a more effective incentive for CRAs to adhere to the appropriate standards of professional practice than a civil liability regime, since it is both transparent and proportionate where penalties are concerned, and avoids the many risks and ambiguities outlined above that would need to be considered in the context of a civil liability standard.

(32) If so, what could be the appropriate standard of fault? Should rating agencies only be liable for gross negligence and intent?

As noted above, a meaningful and consistently interpreted standard of fault would be difficult to establish, given the high-level nature of many of the regulatory obligations concerned, the different national

legal systems into which the standard of gross negligence and intent (or otherwise) would have to be translated, and the difficulties in identifying a "grossly negligent" rating relative to a correctly prepared and issued one.

(33) Should such a potential liability regime cover solicited as well as unsolicited ratings?

While introduction of a liability regime covering both types of rating would do little to further the Commission's objective of encouraging more widespread provision of unsolicited ratings, we would see no case for distinguishing between the two in liability terms if an action were to be based on breach of the CRA Regulation. The obligations under the CRA Regulation cover both types of rating– and indeed unsolicited ratings carry additional disclosure obligations to ensure that investors are aware of the parameters and limitations surrounding these ratings. We note also that the fining and other sanction powers of ESMA in relation to CRAs do not distinguish between solicited and unsolicited ratings, and we believe that this is appropriate.

Limiting civil liability to solicited ratings implies that an action would only lie at the suit of the party soliciting the rating; which is presumably not the case since investors are just as likely, if not more likely than issuers to suffer damage as a result of negligence or other breach of regulatory standards. Difficulties could also arise in determining the appropriate liability position in relation to (for example) ratings that are solicited but not paid for (e.g. in the sovereign context) and in relation to unsolicited ratings that are based largely on existing solicited ratings.

Questions 34-36:

(34) Do you agree that there could be a distorting influence of a fee-paying issuer over the determination of a credit rating?

In principle the "issuer-pays" model can distort behaviour of CRAs and the market given the inherent conflicts involved. However, the same is true for any other model in which a stakeholder in the rating process pays, and no consensus has been reached by authorities or commentators on a superior alternative to the status quo.

As with many other business models and industries in which inherent potential for conflict exists, the appropriate response is to ensure that potential conflicts are well managed and subject to regulatory oversight. Experience in practice also suggests that "issuer-pays" conflicts can be managed by effective governance structures and successful segregation of functions and information within an entity. Further detail on examples of CRAs' policies and procedures in place to pre-empt and manage conflicts are outlined at Annex 1.

The CRA Regulation supports and formalises the basis on which conflicts should be managed. It is too early given the recent changes to determine that conflicts will not be managed appropriately and that alternative standards should be put in place to compensate for shortcomings in a set of new regulatory standards, where these standards are supported by international consensus in the form of the IOSCO code and already purport to reflect best practice for conflicts management.

(35) What is your opinion on the proposed options/alternatives to reduce conflicts of interest due to the “issuer-pays” model? If so please indicate which alternatives appear to be the most feasible ones and why.

We believe that it is important for the European regulatory regime to continue to support a plurality of business models and maintain a level playing field for CRAs based on market demand. In particular, regulators should not legislate to reduce or prohibit use of the “issuer-pays” model where conflicts can be shown to be managed effectively, and there is no compelling evidence to suggest that alternative models would be more effective. In this respect, we note the comments in the draft Klinz report that the conflicts that arise under this model can be addressed by prohibition on advisory services and ensuring independent governance, and that “all payment models have flaws or practicability questions that make them difficult to consider as true alternatives.”¹⁷ While we support the exploration of alternatives to the “issuer-pays” model, we agree that all such measures create their own issues in terms of feasibility and/or greater scope for conflicts. Our views on the alternatives proposed are as follows:

(a) Subscriber/Investor pays model

This model would need to be in a form such that investors are required to subscribe to one or more agencies before being allowed to purchase. Such a requirement would be likely to reduce demand for such securities (given the additional cost associated with their purchase). It would also be likely to result in greater reliance by investors on CRA ratings, given the direct contractual nexus between the CRA and the investor. It would also require multiple CRAs and we do not believe that the additional expense to investors and the market would not be justified on cost-benefit grounds. Please also see the answers to Questions 23-30 on the difficulties of stimulating new entry to the sector and the risks of fragmentation and compromised quality standards.

An “investor-pays” model would also be vulnerable to conflicts of interest, since large institutional investors could distort the market by

¹⁷ DRAFT REPORT on credit rating agencies: future perspectives (2010/XXXX(INI)), Committee on Economic and Monetary Affairs /Wolf Klinz, p.11

incentivising CRAs to rate assets in their portfolios favourably to make them more attractive. This would be particularly so if only large institutional investors were prepared (or required) to obtain and pay for a rating, which could make them the only source of income for CRAs. There would also be difficulties acknowledged by the Commission with keeping ratings private and preventing "free-riding" by other, non-paying investors. Such a model would not encompass non-EU investors and, would therefore create an uneven playing field. We also note that some NRSROs in the US have tried to employ an "investor-pays" unsuccessfully, having found that investors are generally unwilling to pay for the ratings.

(b) Payment upon results model

This fundamentally misunderstands the process of credit ratings and imposes significant and unjustified restrictions on CRAs' economic model. It would be likely to increase the overall costs associated with ratings considerably, particularly given the cost of establishing a body responsible for independently monitoring and evaluating "performance" of ratings in order to determine the fees that should be payable to CRAs (assuming that this could not be established by CRAs' clients for conflicts reasons).

(c) Trading venue pays model

This arguably does not mitigate the conflict (as issuers choose trading venues), and trading venues would in any case be unable to absorb the prohibitive costs associated with obtaining ratings for all traded instruments unless they were able to pass them on to issuers. As noted in the Consultation Paper, this would be unworkable for non-listed issuers or instruments, which would have to be funded by an alternative model. This could lead to inconsistent standards and practices for listed and non-listed issuers/instruments and create opportunities for regulatory arbitrage.

(d) Government as hiring agent model

We note the acknowledgement by the US authorities of the practical difficulties associated with such an approach (as proposed under the so-called "Franken amendment" to the Dodd Frank Act), particularly with respect to the criteria and procedures governing the hiring process, which we agree would be very difficult to determine. As noted above in our introductory comments, we suggest that the Commission should monitor the progress of the US authorities in assessing the viability of such an approach as part of the SEC's ongoing feasibility study. To introduce any equivalent model in Europe in the meantime, however, risks creating competitive distortion within the European market and creating greater divergence in standards at a global level.

(e) Public utility model

There would be no guarantee that the governmental check would result in better ratings, though the likelihood of this would be increased by devoting substantial funding and expertise to the validating body. As noted above in relation to Questions 23-30, the creation of publicly subsidised and/or administered models has the potential to distort the market and compromise the independence of ratings.

A validation framework which allows an EU or state-subsidised entity to "approve" individual rating decisions would sit uncomfortably with the requirement at Article 23 in the CRA Regulation that public authorities of Member States should not interfere with the content of individual ratings, even in the context of ostensibly validating the methodologies employed by CRAs. It would be more effective and appropriate for resources at a European level to be focused on effective monitoring and enforcement of the regulatory framework underpinning the ratings process than on attempting to validate the integrity of individual decisions.

In addition the transitional regime between the current and any new regime would need careful consideration, given the economic impact on CRAs.

(36) Are there any other alternatives to be considered? If so please explain.

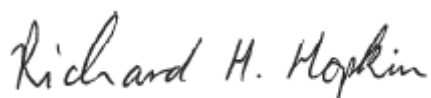
We do not propose other alternatives for consideration.

(37) Are there any other issues that you consider should be tackled in the forthcoming review of the CRA Regulation?

There is a clear need to ensure that regulatory reform is undertaken with due care, following a cost-benefit analysis and at a considered pace. In our opinion, given the relative novelty of the CRA Regulation, it is too early to consider making material changes to the CRA regulatory framework. The political pressure (which we understand) to reform CRAs further, in particular in the sovereign space, is however not grounded in any evidence that ratings in Europe have failed to perform according to expectations. Further changes should only be made once there has been sufficient time to reflect upon and meaningfully assess the impact of recent changes upon CRAs, markets and market participant behaviour. That assessment should further take into account the numerous other regulatory changes that have occurred in the last two years and those which are due for implementation. For example, a horizontal assessment of the cumulative impact of CRD2, CRD3, MiFID2, Solvency 2 and the CRA current and future regulation on securitisation markets has not yet been undertaken.

By continuing to impose regulation upon regulation, often in a piecemeal fashion that overlaps the same market sectors, without leaving time for assessment of the impact of changes, individually and collectively, the European authorities risk designing a regulatory framework that so over-shoots the mark that it fails to address the true causes of past problems. The side-effects will be to hinder the development and recovery of markets, and in turn limit the funding available to help European issuers (including sovereigns) recover from the difficulties of recent years. European banks face significant funding challenges in the next several years in order to meet the new liquidity and stable funding requirements of Basel 3 (see further below). In our view it is essential that public policy supports and encourages free and transparent funding markets governed by evidence-based, well calibrated regulation, rather than wholesale actions which drive investors away, increase funding costs and delay economic recovery.

Yours faithfully,



Richard Hopkin
Managing Director
AFME



Sally Springer
Senior Policy Director
BBA

ANNEX I:**Association for Financial Markets in Europe (AFME)**

AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME was formed on 1st November 2009 by the merger of the London Investment Banking Association and the European operations of the Securities Industry and Financial Markets Association.

AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets. AFME is the European regional member of the Global Financial Markets Association (GFMA) and is an affiliate of the US Securities Industry and Financial Markets Association (SIFMA) and the Asian Securities Industry and Financial Markets Association (ASIFMA). For more information, visit the AFME website, www.AFME.eu.

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

British Bankers Association (BBA)

The BBA is the leading association for the UK banking and financial services sector, speaking for over 200 banking members from 60 countries on the full range of UK or international banking issues and engaging with 35 associated professional firms. Collectively providing the full range of services, our member banks make up the world's largest international banking centre, operating some 150 million accounts and contributing £50 billion annually to the UK economy.

BBA is listed on the EU Register of Interest Representatives, registration number 5897733662-75.

ANNEX II: TYPICAL CRA POLICIES AND PROCEDURES FOR THE MANAGEMENT OF CONFLICTS OF INTEREST UNDER THE ISSUER-PAYS MODEL

Appointment

- There are distinct Chinese walls between the commercial side and the transaction analysts. These are rigidly enforced in practice.
- Fees are based on a published tariff and not individually negotiated. Contracts will generally also contain a break clause, which permits a CRA to cease acting if a conflict arises post-engagement; usually with no punitive impact on fees.
- Analysts and Issuers are not permitted to discuss or even cc any communications regarding fees and contract terms with analysts before or after appointment.
- Analysts are unaware of any detail of the commercial terms of engagement, which will have no bearing on analysts' ability to commence work on a rating or the basis for the analysis.
- Analysts are rotated on a regular basis and therefore Issuers in practice are not aware of which analysts will be engaged to rate their transaction and cannot have any influence over the appointment.
- In practice decisions on appointment are most often driven from feedback from Arrangers who will be guided by investors. The desire for a rating from specific CRAs is driven by market/investor requirements so Issuers generally do not have a choice as to which CRAs to seek ratings from.

Criteria Development

- There is a clear, open and transparent process for development and publication of ratings criteria
- The criteria development process involves all parties including Issuers, Arrangers, Support Counterparties, Trustees and Investors.

Ratings Process

- Issuers have a single point of contact with the analyst team.
- Decisions confirming results from analysis and guidance on ratings for given structures etc. is made by Committee
- Analysts cannot confirm structure or points of principle without committee approval.
- Issuers have no knowledge of committee members and therefore cannot exert any influence of pressure on decisions
- Similarly there is a strict protocol on the issuance of final ratings and publication thereof.
- Ratings are subject to periodic ongoing monitoring requirements, which provides a recurring independent quality check on the original rating.