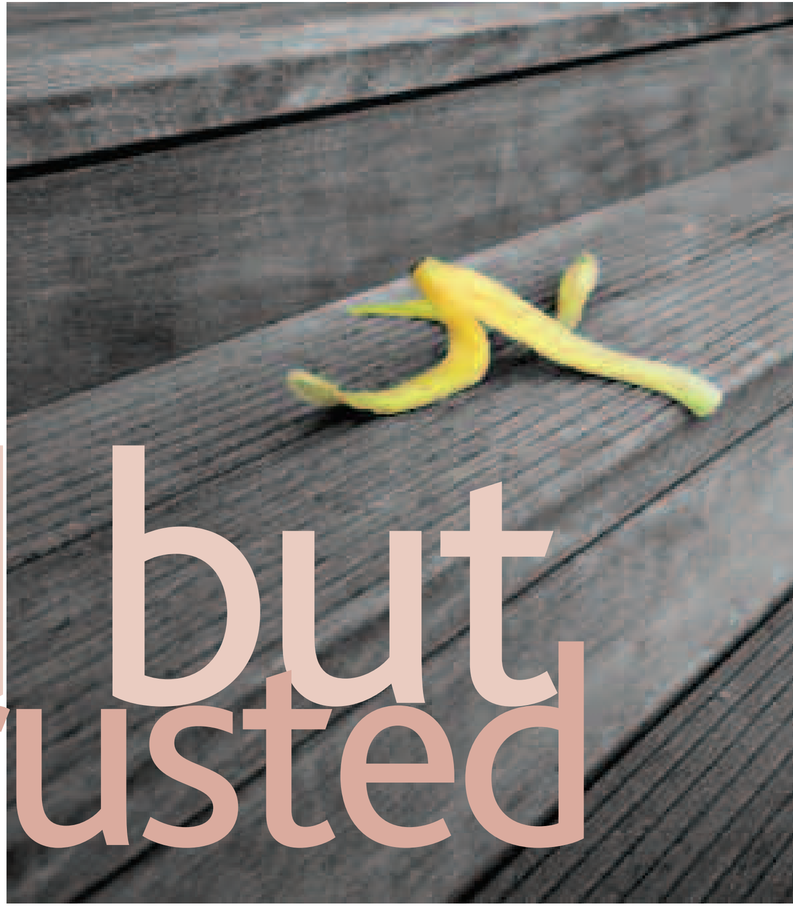

Tried but not trusted

Moody's Investment Services stopped carrying out unsolicited ratings in 2000 because, compared with solicited ratings, they are less informative and not well received by investors and issuers alike, according to Eric De Bodard, Managing Director at Moody's Paris.

He says: "It is true that they can bring diversity into the market but some market participants will see them as being less informative because the issuer has not participated in the process."

While Standard & Poor's generally uses unsolicited ratings for insurance companies only, Fitch ratings accept them as a legitimate practice that is not only good for investors but also aids competition and diversity of opinion.

Trevor Pitman, Group Managing Director at Fitch, says: "Historically, many market participants have said that it is unsatisfactory for there to be only two major rating agencies, Moody's and S&P, which have a duopoly in the market. When you approach companies to solicit another rating, they refuse because you don't have an established track record."

A STRICT PROCESS Pitman argues that unsolicited ratings follow a strict format and process that is not negative for the issuer and helps to advance and establish smaller rating agencies.

He says: "The fact is, people want competition in the market but they are not prepared to do anything about it. Regulators will not outlaw unsolicited ratings because they know it is the only effective way that competition can be created in the rating agency industry."

Fitch carries out unsolicited ratings in response to demand from investors. If Fitch decides there have been enough enquiries about a borrower it will invite the company to provide information for a solicited rating. If the borrower declines, Fitch may or may not continue with a rating depending on the strength and detail of the public information available.

Pitman says: "We know we may be reliant on public information only, so we have to be sure that it is detailed enough. If this is not the case, we would not be able to proceed."

The company is then informed that the rating process is under way and told when it will be published. It is invited to provide further information every step of the way.

Pitman says: "We go through a fully analytical process which is exactly the same as a solicited rating process. We use all significant information, which is collected before going to the ratings committee. We have an internal committee discussion and then we assign the rating."

Executive summary

- Unsolicited ratings have been a contentious issue for issuers, investors and rating agencies for some time. While the IOSCO code of conduct goes some way to providing a recommended framework for rating agencies, lack of regulation has led many to believe that agencies have too much power in the market.

WHAT'S THE PROBLEM? So if unsolicited ratings are not against the rules and provide a service for the market, why do some issuers feel they should be stopped or more heavily regulated?

De Bodard argues that the market does not respond well to unsolicited ratings and that they do not currently have a worthwhile use for investors and issuers.

He says: "Years ago we did do unsolicited ratings because we believe it offered a valued service to the market. But, in fact, we didn't receive much support from the market so we stopped the practice. The important thing is that they are not well understood by market participants."

Scepticism about unsolicited ratings comes in part from a belief that issuers are rated lower than would be the case had they paid for solicited ratings. So are they merely a marketing ploy to get more issuers to cough up the cash for a more favourable outcome?

Pitman says: "A comprehensive study of our agency-initiated ratings shows that this simply isn't the case. 40% come out at the same level as other agency ratings; roughly 30% above and 30% below. There is no question of ratings fees playing a role in the rating decision for an unsolicited rating. Once we have told a company that we will be publishing a rating we won't even discuss fee arrangements with that company for at least 12 months after publication even if they ask us to."

Fitch says issuers are given plenty of opportunities to meet up and discuss the rating and information used. In some cases the

JULIA BERRIS WEIGHS UP THE ARGUMENTS FOR AND AGAINST THE WIDER USE OF UNSOLICITED RATINGS.

publication date will be deferred if the issuer needs more time to discuss the details and participate.

Pitman says: "Some companies say they cannot participate and provide information because there is not enough management time available. But it is just the same information that would be given to another agency. It's hard to see how that can take up much more time."

Pitman accepts that there is some hostility in the market on this topic. However, with the policy that all unsolicited ratings are now marked as such when published, coupled with regulator refusal to clamp down on the practice, it seems the hostilities are dying down.

CHANGING PERCEPTIONS Pitman says: "In the UK it is not so much of an issue. On the continent there tends to be more private ownership of companies. These companies have perhaps used the capital markets a little less than their UK counterparts. They will therefore be less familiar with ratings. However, this is changing now and these companies are becoming much more experienced."

Bank supervisors using ratings for capital purposes under Basel II have grown more comfortable with unsolicited ratings as the agencies have become more transparent on the topic. Germany, which initially proposed not to accept unsolicited ratings, changed its mind to include all ratings irrespective of whether the agency is paid or not.

Despite the importance of their role, rating agencies do not control the market. The International Organisation of Securities Commissions (IOSCO) code of conduct plays a huge part in ensuring agencies adhere to a common set of standards that guide how they operate.

Even so, competition is still minimal; just three rating agencies dominate the market. With S&P, Moody's and Fitch occupying the top spots in the ratings world, are unsolicited ratings the only way for new, smaller agencies to get a look-in?

Pitman says: "It is vital for competition. We respond to market requests for ratings and by doing so we facilitate a diverse market. If the market wants access to genuinely independent opinions – even when an issuer initially asks for a rating, it is not unknown for them to stop paying if they don't like a rating – then unsolicited ratings are a necessity, not a problem."

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