The Association of Corporate Treasurers

Comments in response to

QUESTIONNAIRE ON THE DAY-TO-DAY APPLICATION OF THE IOSCO CODE BY THE CREDIT RATING AGENCIES

THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS,

6 July 2006

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The Association of Corporate Treasurers (ACT)

Established in the UK in 1979, The Association of Corporate Treasurers is a centre of excellence for professionals in treasury, including risk and corporate finance, operating in the international marketplace. It has over 3,600 members from both the corporate and financial sectors, mainly in the UK, its membership working in companies of all sizes in various capacities.

The ACT has 1,500 students in more than 40 countries. Its examinations are recognised by both practitioners and bankers as the global standard setters for treasury education and it is the leading provider of professional treasury education. The ACT promotes study and best practice in finance and treasury management. It represents the interests of non-financial sector corporations in financial markets to governments, regulators, standards setters and trade bodies.

General

The ACT welcomes the opportunity to comment on this matter. Contact details are provided at the end of this document.

In preparing the response to this questionnaire the ACT has alerted it members to the matter and has explicitly consulted its Credit Rating Working Group consisting of some sixty members and other interested professionals.

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Background

1. Acting in this context as a representative body and not a rated company, it is not appropriate that we seek to answer each of the questions, one by one. We are able to synthesise a response which addresses some of the issues.

2. The questionnaire is drafted so as to solicit replies instancing examples of non-compliance by rating agencies with the IOSCO Code fundamentals. Perhaps this is inevitable when one is looking at compliance. However we believe that questionnaires are more likely to produce useful results if they are worded in a neutral way – "Have the methodologies used by CRAs been consistently applied (if not, please give examples)?" rather than "Do you know of cases where the methodologies used by CRAs were not consistently applied?".

   It is important that the responses received by CESR are evaluated in the knowledge of this possible bias in some questions.

   If the event, we have not received negative feedback about the rating agencies except in one respect with regard to the agencies' consultations on rating methodology change.

Response

The comments below relate to the major North American rating agencies – mainly to Moody's, Standard and Poor's, and Fitch.

The questionnaire generally

No examples of rating agency non-compliance with the codes either generally or as highlighted by your questions have been drawn to our attention. It is worth noting that in fact the last couple of years have been noticeable for the lack of rating agency type issues coming in to the ACT office through the technical help-line we offer. Previously we have had the odd one or two per year. We do not want to encourage rating agency complacency, but there it is.

Rating methodologies; key factors

As regards information about rating methodologies and what are the key factors affecting ratings of companies in difference sectors/geographies etc., members have told us that agencies have been doing a much better job of letting rated companies know about both the general position and that of their own industry/sector and their particular rated entity/ies.

In the past much of the non company-specific material issued by the agencies was heavily based on US data and practice. Now it is more often citing experience in more than one geographic area and is more user friendly for European based issuers.

Agencies may not be producing much more of such material, but members are much more aware of it so the agencies seem to be doing a better job in communicating.

Rated companies also seem to be getting more feedback from agencies at the agencies' initiative on the reasons for rating or changes in ratings or placing of ratings on review.

Rating agencies also seem to be doing a better job of publicly consulting on proposed rating methodology changes. It is, however, too early to draw a conclusion on just how well this is working.

- The impression we get is that rating agencies are publicly consulting on what they have already decided to do. It would be better to consult initially on possible ways of dealing with a perceived issue:
    - to see if others have any better suggestions
    - to test opinion as to whether any of the possibilities set out, on reflection, are better than the previous approach (which may have been to ignore the issue).

  This would reduce the effect of the agencies being pressured into a particular "solution" which suits an influential narrow sector of ratings users in one market.

- The time allowed for comment by the rating agencies is far too short. It can to be just one month. This is not adequate. Potential respondents are not just waiting for a consultation to which they can respond. Respondents need time not only to fit consideration of the matter into their schedule, but perhaps also to consult others, inside and outside their companies, about aspects of the matter or of possible responses. This is especially true, for example, if the respondent may include suggestions of modified or alternative proposals or if they see implications for particular sectors or jurisdictions.

- Further, the timing of consultation can aggravate this limited-time problem. A one month consultation in the period from mid-July to end-August corresponds with the peak holiday period in the UK. UK authorities sometimes give in to the temptation to consult on "difficult" issues at this time to reduce the number of negative or critical responses but, more generally, they seek to avoid the period.[1] There is a lesser problem of the same time with consultations between the last week of December and mid-January. Rating agencies should seek to avoid these periods if they really want proper attention to their consultations.

[1] Of course, this CESR questionnaire itself also partly falls into the holiday period….

Continuing ratings

One topic has come to our attention recently. It is about what happens when an issuer decides it no longer wants to pay for a rating, not where the rated security is retired or the company ceases trading, but because the company does not like the revised rating likely to be announced.

We note in our Handbook[2] that

> "Once the first rating of a company has been given it becomes very difficult in the market to cease to have a rating even if subsequent rating changes are regarded as unfair by the company."

This is because once investors have purchased obligations of the company or business partners (suppliers, customers, joint venturers, etc.) have undertaken business with the company or taken credit exposures on the company partly based on knowledge of the credit rating, they will look to the credit rating to continue while the relationship continues.

It is a matter of concern that issuers should not, after the initial solicited rating, have a veto on the rating agency adjusting and issuing the rating as they judge appropriate – even if the company disagrees with the rating. The whole point of the rating is that the rating agency is a delegated monitor of credit independent of the issuer and that the rating can be expected to be kept up to date.

The rating agencies explain when a company is considering a rating for the first time that they reserve the right to go on issuing ratings (eventually based only on public information of course) even if the company cancels the contract with the agency. And in the rare cases that a company ceases paying for a rating under the circumstances under consideration, the agencies do usually go on issuing such a rating.

We consider this practice of the agencies to be very important for the integrity of the markets.

We have heard that some issuers are pressing for prohibition of the continuing, un-remunerated, rating. This is clearly the affected issuers "talking their own book". Such a move would:

- put pressure on agencies not to make (presumably negative) rating adjustments they consider to be necessary
- put agencies in a position where they would be unable to carry out their obligations to users of the ratings
- be strongly against the public interest.

Unsolicited ratings

We do receive comment from time to time from those of our members whose companies have been subject to an unsolicited rating. For the recipient it can feel like unwelcome

[2] The Treasurer's Handbook, 2006, "Corporate Credit Ratings – a quick guide", p222.

pressure from the agency to pay for a rating. However we recognise that in terms of encouraging new agencies, allowing them to build up a track record and fostering competition amongst the agencies the practice of rating companies based solely on public information can serve a valuable purpose for the market as a whole. Indeed in the context of continuing ratings mentioned above it is to be welcomed.

However without access to management and to confidential information there is the possibility that unsolicited ratings may be of different quality to conventional ratings – at the very least their methodologies will be different. For this reason the IOSCO Code stipulates that unsolicited ratings should be disclosed as such.[3] Of the major rating agencies Fitch Ratings is the one that seems to use unsolicited ratings most actively. They do comply with the code, since disclosure of non participation by the issuer is always mentioned in their detailed credit analysis. However in their case the access to this analysis is by subscription. The basic credit rating levels which are accessible more readily include no mention of the fact that these sorts of rating are based only on public information. As a general comment the addition of a subscript to a rating to indicate the lack of issuer involvement would go a long way to meeting some of the quite understandable issuer concerns and would convey additional messages to the users. For example Standard & Poor's do have a PI subscript qualifier where only public information has been used.

Contacts:
Richard Raeburn, Chief Executive
(020 7213 0734; rraeburn@treasurers.org)
John Grout, Technical Director
(020 7213 0712; jgrout@treasurers.org)
Martin O'Donovan, Technical Officer
(020 7213 0715; modonovan@treasurers.org)

The Association of Corporate Treasurers
Ocean House
10/12 Little Trinity Lane
London EC4V 2DJ
Telephone: 020 7213 9728
Fax: 020 7248 2591
Website: http://www.treasurers.org

The Association of Corporate Treasurers is a company limited by guarantee in England under No. 1445322 at the above address

[3] IOSCO Code of Conduct Fundamentals for Credit Rating Agencies - Dec 2004, section 3.9 "For each rating, the CRA should disclose whether the issuer participated in the rating process. Each rating not initiated at the request of the issuer should be identified as such. The CRA should also disclose its policies and procedures regarding unsolicited ratings."