Comments
on IOSCO October 2004 draft: Code of Conduct Fundamentals for Credit Rating Agencies

Association for Financial Professionals (United States)

Association Française Des Trésoriers D'Entreprise (France)

Association of Corporate Treasurers (United Kingdom)

November 2004

Association for Financial Professionals

With the Support of the International Group of Treasury Associations and Euro Associations of Corporate Treasurers:

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Association for Financial Professionals
(AFP) (United States)

Association Française Des Trésoriers D'Entreprise
(AFTE) (France)

Association of Corporate Treasurers
(ACT) (United Kingdom)

November 2004

Comments on IOSCO draft: *Code of Conduct Fundamentals for Credit Rating Agencies*, October 2004

1. Introduction

1.1. The Treasury Associations

A description of the Association Française Des Trésoriers D'Entreprise, the Association of Corporate Treasurers and the Association for Financial Professionals are provided below. For ease of reference the three are referred to as *the Treasury Associations* in these comments.

The Treasury Associations' members are involved in the credit ratings industry as issuers of rated obligations, as investors in rated obligations and as users of ratings for a variety of business purposes.

1.2. The IOSCO draft Code of Conduct Fundamentals

The Treasury Associations broadly welcome IOSCO's draft *Code of Conduct Fundamentals*.

The *Code of Conduct Fundamentals* contributes as a basis for a sound code of conduct for credit rating agencies and thus for participants in the ratings industry generally.

Comments are made below on individual elements of the *Code*, on the two questions set out for separate comment, and also on certain aspects of the *Preamble* and of the *Introduction*.

Great importance is attached to information provided to CRAs by rated issuers. An indication of the type and extent of information is provided in the Appendix which is taken from the ACT's *The Treasurer's Handbook, 2004*.

About the Association of Corporate Treasurers

The Association of Corporate Treasurers (ACT), based in London, England, is an organisation of professionals in corporate finance, risk and treasury and cash management operating internationally. Formed to promote the study of and best practice in finance and treasury management, it has over 3,300 members and 1,200 students in more than 40 countries. Its education and examination syllabi are recognized by both practitioners and bankers as the global standard setters for treasury education. The ACT represents the interest of non-financial sector corporations in financial markets to regulators, standards setters, trade bodies, etc.

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About the Association for Financial Professionals

The Association for Financial Professionals (AFP) headquartered in Bethesda, Maryland, supports more than 14,000 individual members from a wide range of industries throughout all stages of their careers in various aspects of treasury and financial management. AFP is the preferred resource for financial professionals for continuing education, financial tools and publications, career development, certifications, research, representation to legislators and regulators, and the development of industry standards.

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About Association Française des Trésoriers d'Entreprise (AFTE)

Association Française des Trésoriers d'Entreprise (AFTE), founded in 1976, represents more than 1,400 members, including 1,050 Corporate Treasurers or Financial Managers of approximately 900 industrial and commercial companies; 450 members are based in the provinces. There are also 350 correspondent members. Its development is concentrated on five activities: technical committees, conferences, education, publications and representation of corporate treasurers. AFTE is a founding member of the Euro Associations of Corporate Treasurers (EACT).

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2. Summary of principal observations

- The Treasury Associations broadly welcome the draft *Code of Conduct Fundamentals.* In a competitive market, the market is seen as the ultimate and best regulator of CRAs and the Treasury Associations would regret the extension of regulatory oversight to jurisdictions where it does not currently exist. A *Code* is potentially especially useful in such markets.
- The Treasury Associations firmly believe that issuers should abide by disclosure rules applicable to them. However, the policing role envisaged for CRAs by *Code* item 3.11 (publication of disclosable unpublished information about a listed issuer which comes to their attention) is wholly inappropriate. It would totally the change the relationship of trust needed for issuers to make full and proper disclosure to a CRA, to the detriment of issuers and investors generally. 3.11 should be deleted from the draft *Code.*
- The concept of requiring use by a CRA of *all* available information (1.1) is not consistent with the idea that CRAs can offer their own (published) methodology. That methodology may indeed be comprehensive in its consideration of available information, or it may be highly selective, as with a purely statistical analysis of selected elements of published financial data. Accordingly, the Treasury Associations suggest modifications to 1.1 and 1.4
- The Treasury Associations agree that a CRA and its employees should comply with all applicable laws, rules and regulations governing its activities in each jurisdiction in which it operates. However, exemptions may be needed in securities regulations regarding disclosure requirements on listed entities for disclosures to CRAs and the addition of a note to this effect is suggested in comments on 1.11.
- The Treasury Associations believe that, within a CRA, analysts and others involved in rating an issuer should be independent of any connection with direct competitors, customers or suppliers of the rated entity and an amendment to 2.13 is proposed accordingly.
- The Treasury Associations believe that some extension to restrictions on trading for those in possession of confidential, non-published information provided by rated issuers is required. See the Treasury Associations' comments on 2.14.

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3. Comments on the Preamble to the *Code*

3.1. Re: Preamble, paragraph 3

The Treasury Associations do not see the need for specific regulation of CRAs except in certain very selected ways.

Accordingly the Treasury Associations generally welcome the IOSCO publication of a code with its inherent flexibility.

The Treasury Associations would find it regrettable if additional securities regulators, that do not currently regulate CRAs, decided to introduce specific regulatory oversight of CRAs. Market mechanisms should be the principal oversight mechanisms for CRAs, which should be subject to normal market abuse, competition and other regulation[5]. An outside arbitration body to enforce codes of conduct[1] is not necessary or desirable: commentary by associations and other participants in the industry – users and issuers – should be quite sufficient in a competitive market. Over time, issuers and users may migrate to CRAs that develop and adhere to codes of conduct that address the fundamentals in IOSCO's *Code* and other issues that may be raised by market participants.

Of course, rejection by CRAs of sensible codes or repeated abuse over an extended period may indicate the need for regulatory action

Where regulatory oversight of CRAs exists, the Treasury Associations have urged regulators to establish clear criteria for recognition of CRAs in order to minimise regulatory barriers of entry for new CRAs. Recommendations for regulators currently overseeing CRAs were included in the Treasury Associations' draft *Code of Standard Practices for Participants in the Credit Rating Process*. Similar recommendations were carried through into the code sections dealing with CRAs and issuers in order to address these recommendations in jurisdictions where no regulatory oversight exists[2].

3.2. Re: Preamble, paragraph 4

The Treasury Associations believe that the attention given by IOSCO to the matter of CRAs has itself had a beneficial effect in concentrating the minds of CRAs themselves and of industry participants generally.

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[1] Such as the International Chamber of Commerce considered in part 2 of paragraph 5 of the preamble.

[2] The AFP has a developed position on this in the United States, where the SEC has a process for recognizing CRAs as *Nationally Recognized Statistical Rating Organizations.* Despite the name, the SEC recognises rating agencies that are not wholly statistically driven in their ratings, but use a wide spectrum of information types including that from access to confidential non-published information concerning issuers. In Congressional testimony, the AFP has commented: "A reasonable regulatory framework that minimizes barriers to entry and is flexible enough to allow innovation and creativity will foster competition among existing NRSROs and those that may later be recognized and restore investor confidence in the rating agencies and global capital markets. Rather than excessively prescriptive regulatory regimes, innovation and private-sector solutions, such as the Treasury Associations' Code of Standard Practices, are the appropriate responses to many of the questions that have been raised about credit ratings."
(http://www.afponline.org/pub/pdf/091404_kaitz_testimony.pdf)

The Treasury Associations started work on a credit ratings industry code of practice in late 2002. The exposure draft of this code[3] set out to embrace both CRAs and issuers as well as to offer regulatory recommendations for jurisdictions where local regulation of CRAs is already in effect.

IOSCO's consideration of a code of conduct rather than prescriptive law or regulation is welcome. The draft *Code of Standard Practices for Participants in the Credit Rating Process* put forward by the Treasury Associations will be reviewed with a view to building on IOSCO's final *Code of Conduct Fundamentals* as well as taking account of comments received.

3.3. Re: Preamble, paragraph 5

The "separate issues" in parts 1 and 2 of paragraph 5 are dealt with below (see page 20)

[3] Exposure draft *Code of Standard Practices for Participants in the Credit Rating Process*, published earlier in 2004, is in Appendix 2 to these comments and available on the Treasury Associations' web-sites (listed on page 2, above) in English and in French.

4. Comments on the Introduction to the *Code*

4.1. Re: Introduction, paragraph 2

The Treasury Associations do not see the need for specific regulation of CRAs except in certain very selected ways[4].

Accordingly the Treasury Associations generally welcome the IOSCO publication of a code with its inherent flexibility. The advantage of a code is that it can be applicable in all types of environments without the need for specific (and potentially different) regulations in every country where issuers are rated.

4.2. Re: Introduction, paragraph 3

CRAs' protection of the integrity of the rating process is part of their stock-in-trade enabling them to market themselves successfully to investors and issuers. Fair treatment of those "customers" is commercially prudent. If CRAs abuse confidential information provided by issuers, issuers are unlikely to go on providing it and if the CRAs' business models involve use of that information as an essential part of the rating process, their commercial interests are in giving issuers confidence in their handling of such data. Such rating agencies normally require some exemption regarding a listed issuer's need to disclose "material" or "price-sensitive" information provided to CRAs (see comment on 1.11 of the code, below). For example, CRAs benefit from such an exemption from Regulation Fair Disclosure (FD) in the US. Withdrawal of that exemption would weaken such a CRA's business model and conditionality of that exemption would be a powerful tool for regulators, easily provided, without needing a wider framework of CRA regulation.

Provided that there are no regulatory hurdles adding to the inevitable reluctance of issuers to go through the costly process of providing information to a new CRA, the market place is a satisfactory supervisor of CRAs so long as CRAs are subject to normal securities[5] and competition regulations. The market place can be aided by comparison yard-sticks such as industry codes of conduct or best practice. Especial regulation is not necessary.

However, in jurisdictions where CRAs are in fact regulated, it is appropriate that regulators require CRAs to document internal controls designed to protect against the disclosure of non-public information.

4.3. Re: Introduction, paragraph 4

The Treasury Associations believe that the last sentence of this paragraph (referring to reliance on market mechanisms for enforcement of the *Code of Fundamentals*) is especially important for developed markets in which experienced issuers and investors are a major part of the sector.

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[4] See the Treasury Associations' exposure draft of a *Code of Standard Practices for Participants in the Credit Rating Process*, is in Appendix 2 to these comments and is available on the Associations' web-sites (listed on page 2, above) in English and in French.

[5] Where a jurisdiction's securities regulation does not provide for allowing disclosure of information by listed entities under contractual confidentiality generally, it is important for regulators to provide that disclosure to CRAs under contractual confidentiality does not require prompt disclosure to the market by the listed entity– e.g. the "carve-out" for rating agencies in Reg FD in the US.

The advantages of codes are that they provide a clearer focus for monitoring of CRA behaviour as well as drawing attention for the need for users of ratings and issuers so to monitor the CRAs.

Subject to the comments on paragraph 3 of the Introduction above, specific regulation of CRAs is unnecessary. Further, regulation implemented by individual jurisdictional (or regional) regulators risks fragmenting what should be in many respects a global activity. Investors should be able to understand the meaning of a rating and the general conditions which will have surrounded its determination irrespective of the location of the CRA, the issuer or the markets in which obligations of the issuer may have been listed.

4.4. Re: Introduction, paragraph 5

It is important to note that where the CRAs' models depend on non-public information from the issuer, the CRAs perform only part of the rating process. A key part is performed by the issuers whose obligations are to be rated – by providing access, information and explanation. Accordingly, the exposure draft of a *Code of Standard Practices for Participants in the Credit Rating Process*[4] issued by the Treasury Associations includes measures covering the issuers as well as the CRAs.

4.5. *Re: Introduction, paragraph 6*

The Treasury Associations believe that there is a fundamental difference between CRAs whose business model is predicated on the use of confidential, non-published information and payment from users and CRAs using only published, publicly available information.

In the former, the processes of such CRAs are much more important (see 3.B., below) and a code of conduct is appropriate to give guidance on what the market expects and may expect.

For CRAs, that do not use non-public information and do not receive payments from issuers, process, apart from the manner of release of their ratings, is much more of a commercial matter. Their adherence to a code of conduct generally would be much more a matter of commercial image management.

All CRAs should be subject to general market abuse regulations and other generally applicable law and regulation.[5]

5. Comments on the *Code*

5.1. 1. QUALITY AND INTEGRITY OF THE RATING PROCESS

1.A. Quality of the Rating Process

1.1 *The CRA should adopt, implement and enforce written procedures and methodologies to ensure that the opinions it disseminates are based on a thorough analysis of all relevant information available to the CRA.*

A CRA issuing ratings based solely on statistical analysis of selected published financial information is not using any of the non-financial information available to it. It has decided that only those items of financial information it selects to put into its model are relevant.

By way of contrast to a purely statistically based rating methodology, a CRA basing a rating on published information (about an issuer, its industries and countries of operation, etc.) supplemented by access to top management and confidential non-published information has vast amounts of possibly relevant information potentially available to it. *Thorough* analysis of *all* such information would be a very tough requirement, perhaps prohibitively costly and time consuming to achieve. Selectivity is necessary. Indeed 1.4 in the *Code* refers to a CRA's selection of information believed relevant.

Generally, the model a CRA uses may or may not meet a definition of "thorough". It is up to issuers and users of ratings to evaluate the methodology used by a CRA and the historical and likely future utility of the ratings it publishes.

Accordingly, the Treasury Associations suggest the following amendment to 1.1:

> *The CRA should adopt, implement and enforce written procedures and methodologies to ensure that the opinions it disseminates are based on ~~a thorough analysis of all relevant information available to the CRA~~ consistent processes.*

1.2 *The CRA should use rating methodologies that are rigorous, systematic, and, where possible, result in ratings that can be subjected to some form of objective validation based on historical experience. In assessing an issuer's creditworthiness, analysts involved in the preparation or review of any rating action should use methodologies established by the CRA.*

And 1.3 *In assessing an issuer's creditworthiness, analysts involved in the preparation or review of any rating action should use methodologies established by the CRA.*

The Treasury Associations generally agree with and support these points

1.4 [First concept]
Credit ratings should be assigned by the CRA and not by any individual analyst employed by the CRA; …

The Treasury Associations generally agree with and support this point.

1.4 [Second concept]
… ratings should reflect all public and non-public information known, and believed to be relevant, to the CRA;…

The Treasury Associations believe that point 1.1 is wrong – as stated in comments above. Accordingly the Treasury Associations suggest the following amendment to this part of 1.4:

> *… ratings should reflect all public and non-public information known, and believed to be relevant, to the CRA consistent with its published methodology;…*

1.4 [Third concept]

… and the CRA should use people who, individually or collectively have appropriate knowledge and experience in developing a rating opinion for the type of credit being applied.

The Treasury Associations generally support this point, but suggest that it be expanded. Although ratings are generally determined by a committee or group of analysts rather than individual analysts, the primary analyst assigned to a company plays an important gatekeeper role between the issuer and the CRA. This role gives the analyst the ability to materially influence the outcome of the rating process. As such, the Treasury Associations recommend that the CRAs make available information on the qualifications and experience of the analyst assigned to the issuer due to its potential importance as a source of information to investors. This point should be modified as follows:

> *… and the CRA should use people who, individually or collectively have appropriate knowledge and experience in developing a rating opinion for the type of credit being applied and publish information on the qualifications and experience of the analyst assigned to the issuer.*

1.5 *The CRA should maintain internal records to support its credit opinions for a reasonable period of time or in accordance with applicable law.*

And 1.6 *The CRA and its analysts should take steps to avoid issuing any credit analyses or reports that contain misrepresentations or are otherwise misleading as to the general creditworthiness of an issuer or obligation.*

And 1.7 *The CRA should ensure that it has and devotes sufficient resources to carry out high-quality credit assessments of all obligations and issuers it rates. When deciding whether to rate or continue rating an obligation or issuer, it should assess whether it is able to devote sufficient personnel with sufficient skill sets to make a proper rating assessment, and whether its personnel likely will have access to sufficient information needed in order make such an assessment.*

And 1.8 *The CRA should structure its rating teams to promote continuity and avoid bias in the rating process.*

The Treasury Associations generally agree with and support these points.

1.B. Monitoring and Updating

1.9 *Except for "point in time" ratings that clearly indicate they do not entail ongoing surveillance, once a rating is published, the CRA should monitor on an ongoing basis and update the rating by:*

a. regularly reviewing the issuer's creditworthiness;

b. initiating a review of the status of the rating upon receipt of any information that might reasonably be expected to result in a rating action (including termination of a rating); and,

c. updating on a timely basis the rating, as appropriate, based on the results of such review.

The Treasury Associations generally agree with and support this point. The Treasury Associations' draft *Code of Standard Practices for Participants in the Credit Rating Process*[6] proposed that a rating be re-affirmed after one year in any event.

1.10 *Where a CRA makes its ratings available to the public, the CRA should publicly announce if it discontinues rating an issuer or obligation. Continuing publications by the CRA of the discontinued rating should indicate the date the rating was last updated and the fact that the rating is no longer being updated. Where a CRA's ratings are provided only to its subscribers, the CRA should announce to its subscribers if it discontinues rating an issuer or obligation. Continuing publications by the CRA of the discontinued rating should indicate the date the rating was last updated and the fact that the rating is no longer being updated.*

The Treasury Associations generally agree with and support this point.

1.C. Integrity of the Rating Process

1.11 *The CRA and its employees should comply with all applicable laws, rules and regulations governing its activities in each jurisdiction in which it operates.*

The Treasury Associations are in basic agreement with this provision, but propose that a note for the attention of regulators be added to the *Code* as follows. The added note could, alternatively, be included in the Introduction.

> *The CRA and its employees should comply with all applicable laws, rules and regulations governing its activities in each jurisdiction in which it operates.*
> *Note: where a jurisdiction's securities regulation does not provide for allowing disclosure of information by listed entities under contractual confidentiality generally, it is important for regulators to provide that disclosure to CRAs under contractual confidentiality does not require prompt disclosure of the disclosed information to the market by the listed entity (e.g. the "carve-out" for CRAs in Reg FD in the US).*

1.12 *The CRA and its employees should deal fairly and honestly with issuers, investors, other market participants, and the public.*

And 1.13 *The CRA's analysts should be held to high standards of integrity, and the CRA will not employ individuals with demonstrably compromised integrity.*

The Treasury Associations generally agree with and support these points.

1.14 *The CRA and its employees should not, either implicitly or explicitly, give issuers any assurance or guarantee of a particular rating prior to a rating assessment.*

The Treasury Associations strongly endorse this point.

1.15 *The CRA should institute policies and procedures that clearly specify a person responsible for the CRA's and the CRA's employees' compliance with the provisions of the CRA's code of conduct and with applicable laws and regulations. This person's reporting lines and compensation should be independent of the CRA's rating operations.*

[6] Exposure draft *Code of Standard Practices for Participants in the Credit Rating Process*, published earlier in 2004, is in Appendix 2 to these comments and available on the Treasury Associations' web-sites (listed on page 2, above) in English and in French.

And 1.16 *Upon becoming aware that another employee or entity associated with the CRA is or has engaged in conduct that is illegal, unethical or contrary to the CRA's code of conduct, a CRA employee should report such information immediately to the individual in charge of compliance or an officer of the CRA, as appropriate, so proper action may be taken. Its employees are not necessarily expected to be experts in the law. Nonetheless, its employees are expected to report the activities that a reasonable person would question. Any CRA officer who receives such a report from a CRA employee is obligated to take appropriate action, as determined by the laws and regulations of the jurisdiction and the rules and guidelines set forth by the CRA.*

The Treasury Associations generally agree with and support these points.

5.2. 2. CRA INDEPENDENCE AND AVOIDANCE OF CONFLICTS OF INTEREST

2.A. General

2.1 *The CRA and its analysts should use care and professional judgment to maintain both the substance and appearance of independence and objectivity.*

And 2.2 *The determination of a credit rating should be influenced only by factors relevant to the credit assessment.*

And 2.3 *The CRA should not forbear or refrain from taking a rating action based on the potential effect (economic, political, or otherwise) of the action on the CRA, an issuer, an investor, or other market participant.*

And 2.4 *The credit rating a CRA assigns to an issuer or security should not be affected by the existence of or potential for a business relationship between the CRA (or its affiliates) and the issuer (or its affiliates) or any other party, or the non-existence of such a relationship.*

The Treasury Associations generally agree with and support these points.

2.5 *The CRA should separate its credit rating business and CRA analysts from any other businesses of the CRA, including consulting businesses, that may present a conflict of interest.*

The Treasury Associations strongly endorse this point.

2.B. CRA Procedures and Policies

2.6 *The CRA should adopt written internal procedures and mechanisms to (1) identify, and (2) eliminate, or manage and disclose, as appropriate, any actual or potential conflicts of interest that may influence the opinions and analyses CRAs make or the judgment and analyses of the individuals the CRAs employ who have an influence on ratings decisions. The CRA's code of conduct should also state that the CRA will disclose such conflict avoidance and management measures*

And 2.7 *The CRA's disclosures of actual and potential conflicts of interest should be complete, timely, clear, concise, specific and prominent.*

The Treasury Associations strongly endorse these points.

2.8 *The CRA should disclose the general nature of its compensation arrangements with rated entities. Where a CRA receives from a rated entity compensation unrelated to its rating service, such as compensation for consulting services, the CRA should disclose the proportion such non-rating fees constitute against the fees the CRA receives from the entity for ratings services.*

The Treasury Associations are in basic agreement with this point, but propose that the point emphasise that only the nature of the compensation, and not amounts, be disclosed. The Treasury Associations propose that 2.8 be modified as follows:

> *The CRA should disclose the general nature of its compensation arrangements with rated entities. Where a CRA receives from a rated entity compensation unrelated to its rating service, such as compensation for consulting services, the CRA should disclose the proportion such non-rating fees constitute against the fees the CRA receives from the entity for ratings services. Actual amounts received or receivable in either category need not be disclosed. The CRA should disclose at least annually the proportions of its total revenue arising in each of these categories, from investors and otherwise.*

2.9 *The CRA and its staff should not engage in any securities or derivatives trading presenting conflicts of interest with the CRAs ratings activities.*

And 2.10 *In instances where rated entities (e.g., governments) have, or are simultaneously pursuing, oversight functions related to the CRA, the CRA should use different employees to conduct its rating actions than those employees involved in its oversight issues.*

The Treasury Associations generally agree with and support these points.

2.C. CRA Analyst and Employee Independence

2.11 *Reporting lines for CRA employees and their compensation arrangements should be structured to eliminate or effectively manage actual and potential conflicts of interest. The CRA's code of conduct should also state that a CRA analyst will not be compensated or evaluated on the basis of the amount of revenue that the CRA derives from issuers that the analyst rates or with which the analyst regularly interacts.*

And 2.12 *The CRA should not have analysts initiate, or participate in, discussions regarding fees or payments with any entity they rate.*

The Treasury Associations generally agree with and support these points.

2.13 *No CRA employee should participate in or otherwise influence the determination of the CRA's rating of any particular entity or obligation if the employee:*

- *a. Owns securities or derivatives of the rated entity or any related entity thereof;*
- *b. Has had an employment or other significant business relationship with the rated entity within the previous six months;*
- *c. Has an immediate relation (i.e., spouse, partner, parent, child, sibling) who currently works for the rated entity; or*
- *d. Has, or had, any other relationship with the rated entity or any agent of the rated entity that may be perceived as presenting a conflict of interest.*

The Treasury Associations strongly endorse the fundamentals of this point, but believe that similar relations with competitors of the rated entity should be included too. A suitable amendment for 2.13 would be:

> *No CRA employee should participate in or otherwise influence the determination of the CRA's rating of any particular entity or obligation if the employee:*
>
> - *a. Owns securities or derivatives of the rated entity or any related entity thereof;*
> - *b. Has had an employment or other significant business relationship with the rated entity within the previous six months;*

c. Has an immediate relation (i.e., spouse, partner, parent, child, sibling) who currently works for the rated entity; or

d. Has, or had, any other relationship with the rated entity or any agent of the rated entity that may be perceived as presenting a conflict of interest; or

e. Has or has had (as appropriate) similar relations to those set out above with any direct competitor, supplier or customer of the rated entity.

2.14 *The CRA's analysts and anyone involved in the rating process (or members of their immediate household) should not buy or sell or engage in any transaction in any security or derivative based on a security issued, guaranteed, or otherwise supported by any entity within such analyst's area of primary analytical responsibility, other than holdings in diversified mutual funds.*

The Treasury Associations strongly endorse the fundamentals of this point, but believe that similar restrictions regarding issues related to competitors of the rated entity should also be included. The issuer will almost certainly have shared with the CRA its analysis of its industry and major competitors, customers and suppliers. Knowledge of the current performance, business plans and forecasts of the issuer will also provide insight into their impact, for good or ill, on competitors, suppliers and, in the case of sellers of intermediate or capital goods, their customers.

Furthermore, all such restrictions should continue to apply for a reasonable period after an analyst ceases to have responsibility for such an area of primary analytical responsibility. As much of the information is about forecasts and plans, a period of one year seems to be a reasonable period which may be considered.

It is presumed that "anyone involved in the rating process" includes members of relevant rating committees in the CRA and "secondary analysts" who shadow the primary contact. This is very appropriate.

Accordingly the Treasury Associations recommend the following additions to 2.14

> *The CRA's analysts and anyone involved in the rating process (or members of their immediate household) should not buy or sell or engage in any transaction in any security or derivative based on a security issued, guaranteed, or otherwise supported by any entity within such analyst's area of primary analytical responsibility, other than holdings in diversified mutual funds. These restrictions should apply for a period of one year after the primary responsibility or involvement ceases.*
>
> *Similar restrictions should also apply in relation to securities or derivatives related to direct competitors, customers or suppliers of the relevant entities.*

2.15 *CRA employees should be prohibited from soliciting money, gifts or favors from anyone with whom the CRA does business and should be prohibited from accepting gifts offered in the form of cash or any gifts exceeding a minimal monetary value.*

And 2.16 *Any CRA analyst who becomes involved in any personal relationship that creates the potential for any real or apparent conflict of interest (including, for example, any personal relationship with an employee of a rated entity or agent of such entity within his or her area of*

analytic responsibility), should be required to disclose such relationship to the appropriate manager or officer of the CRA, as determined by CRA compliance policies.

The Treasury Associations generally agree with and support these points.

5.3. 3. CRA RESPONSIBILITIES TO THE INVESTING PUBLIC AND ISSUERS

3.A. Transparency and Timeliness of Ratings Disclosure

3.1 *The CRA should distribute in a timely manner its ratings decisions regarding the entities and securities it rates.*

And 3.2 *The CRA should publicly disclose its policies for distributing ratings and reports.*

And 3.3 *Except for "private ratings" provided only to the issuer, the CRA should disclose to the public, on a non-selective basis and free of charge, any rating regarding publicly issued securities, or public issuers themselves, as well as any subsequent decisions to discontinue such a rating, if the rating action is based in whole or in part on material non-public information.*

The Treasury Associations generally agree with and support these points.

3.4 *The CRA should publish sufficient information about its procedures, methodologies and assumptions so that outside parties can understand how a rating was arrived at by the CRA. This information will include (but not be limited to) the meaning of each rating category and the definition of default and the time horizon the CRA used when making a rating decision.*

The Treasury Associations express basic agreement with these points. However, CRAs do not only publish ratings about the likelihood of default but, in some cases, also about losses in case of default (i.e. "recovery ratings"). The Treasury Associations believe that 3.4 should be extended to include such ratings. Accordingly the following amendment is proposed for 3.4:

> *The CRA should publish sufficient information about its procedures, methodologies and assumptions so that outside parties can understand how a rating was arrived at by the CRA. This information will include (but not be limited to) the meaning of each rating category and the definition of default <u>or recovery</u> and the time horizon the CRA used when making a rating decision.*

3.5 *When issuing a rating, CRAs should explain in their press releases and reports the key elements underlying their rating decision.*

The Treasury Associations suggest that a caution regarding confidential information should be added, to 3.5.

Also where a CRA in its rating release refers to figures modified from those available in information publicly reported by an issuer, this can cause concern to the issuer and among investors and other users of ratings.

Accordingly, the following amendments to 3.4 are proposed:

> *When issuing a rating, CRAs should explain in their press releases and reports the key elements underlying their rating decision. <u>In doing this, care should be taken not to disclose any confidential, non-public information received by the agency from the issuer.</u>*

Where, in its rating commentaries or analysis, a CRA publishes figures about the issuer which differ from the equivalent figure available in the issuer's published information, the CRA should include an appropriate reconciliation to the published figures.

3.6 *Where feasible and appropriate, prior to issuing or revising a rating, the CRA should advise the issuer of the critical information and principal considerations upon which a rating will be based and afford the issuer an opportunity to clarify any likely factual misperceptions or other matters that the CRA would wish to be made aware of in order to produce an accurate rating. The CRA will duly evaluate the response.*

The Treasury Associations strongly endorse this point.

However, if the CRA has not deemed it feasible or appropriate to advise the issuer prior to issuing or revising a rating, the CRA should advise the issuer as soon a practical thereafter.

It may be noted that in the Treasury Associations' draft *Code of Standard Practices for Participants in the Credit Rating Process*[4] it is provided in 7.6 that "Issuers should seek to react as quickly as practicable to communications submitted to them by a CRA prior to their public release by the CRA. While issuers should, in any case, make reasonable efforts to respond as quickly as possible, the time frame in which companies may review the text should be limited (but not less than four business hours) in order to ensure that investors receive timely information and to minimize the possibility of information leaks."

It would surely be wholly exceptional that a CRA would not deem it feasible or appropriate to communicate with the issuer in the way envisaged. However, in case this should happen, the following change to 3.6 is suggested:

Where feasible and appropriate, prior to issuing or revising a rating, the CRA should advise the issuer of the critical information and principal considerations upon which a rating will be based and afford the issuer an opportunity to clarify any likely factual misperceptions or other matters that the CRA would wish to be made aware of in order to produce an accurate rating. The CRA will duly evaluate the response. Where a CRA has not deemed it feasible or appropriate to advise the issuer prior to issuing or revising a rating, the CRA should advise the issuer as soon as practical thereafter.

3.7 *In order to promote transparency and to enable the market to best judge the performance of the ratings, the CRA, where possible, should publish sufficient information about the historical default rates of CRA rating categories and whether the default rates of these categories have changed over time, so that interested parties can understand the historical performance of each category and if and how ratings categories have changed, and be able to draw quality comparisons among ratings given by different CRAs. If the nature of the rating or other circumstances make a historical default rate inappropriate, statistically invalid, or otherwise likely to mislead the users of the rating, the CRA should explain this.*

The Treasury Associations generally agree with and support this point.

3.8 *The CRA should disclose when its ratings are not initiated at the request of the issuer and whether the issuer participated in the rating process.*

The Treasury Associations express agreement with 3.8. However, they believe that it is important that where the issuer participates in the rating

process by giving access to top management and confidential, non-published information, the CRA should only publish a rating on that basis when it has had no reason to suspect that information normally disclosable in such a relationship, that is relevant to the CRA's methodology, has been withheld or may be doubtful.

The following change to 3.8 would achieve that:

> *The CRA should disclose when its ratings are not initiated at the request of the issuer and whether the issuer participated in the rating process. If the issuer did participate in the rating, the CRA should only publish a rating on that basis when it has had no reason to suspect that information normally disclosable in such a relationship, that is relevant to the CRA's methodology, has been withheld or may be doubtful.*

3.9 *Because users of credit ratings rely on an existing awareness of CRA practices, procedures and processes, the CRA should fully and publicly disclose modification of these practices, procedures and processes. The CRA should carefully consider the various uses of credit ratings before modifying its practices, procedures and processes.*

The Treasury Associations generally agree with and support this point.

Attention is drawn to our response[7] to the second "separate issue" (raised in paragraph 5 of the Preamble) which relates to this item. The Treasury Associations endorse the proposed amendment to ensure that the disclosure referred to in that above text takes place prior to a change going into effect.

3.B. The Treatment of Confidential Information

The type of information and the related time-frame for plans, projections or forecasts or evaluations of risks or opportunities provided to a CRA by a rated issuer will vary significantly according to the types of activity being undertaken by the issuer, the time frames involved, and the competitive, technological, geographic, social, regulatory, political and economic contexts.

However, confidential, non-published information here is not limited to "material" or "price sensitive" information of a type mandatorily disclosable to the market which, in some jurisdictions, can be quite narrowly defined. Rather, it commonly includes what in the UK is called, in the context of regulating insider dealing *Relevant Information Not Generally Available* ("RINGA")[8]. And, it also usually includes other information that is commercially sensitive, and so is important to the issuer. An indication of the

[7] See page 21

[8] RINGA – Relevant Information Not Generally Available. See the FSA Handbook, Market Conduct, Chapter 1, Code of Market Conduct, September 2004, section 1.4, Misuse of information (www.fsa.gov.uk). The joint HM Treasury and Financial Services Authority consultation on implementation of the EU Market Abuse Directive ("UK Implementation of the Market Abuse Directive", 18 June 2004, available at November 2004 on www.hm-treasury.gov.uk/consultations_and_legislation/consult_fullindex.cfm) explains (B.23 p. 46) that the concept is used to "explicitly prohibit people from trading to their advantage and to the disadvantage of others on the basis of information not generally available to investors." And, at 3.18, page 18: "This prohibition is important to ensuring that the UK has a flexible insider dealing regime. It enables action to be taken in relation to behaviour based on information which would be taken into account by investors but is not sufficiently precise to be inside information. It might include, for example, information about the state of negotiations over a major contract."

type and extent of information liable to be disclosed to a CRA by an issuer may be seen in Appendix 1, which is taken from the ACT's *The Treasurer's Handbook, 2004*.

CRA ratings based on published and non-published information are known to have taken into account confidential information, so the market impact of ratings decisions by such CRAs is likely to be all the more important.

Issuers and users of ratings need CRAs receiving confidential information to treat it properly.

3.10 *The CRA should adopt procedures and mechanisms to protect the confidential nature of information shared with them by issuers under the terms of a confidentiality agreement or otherwise under a mutual understanding that the information is shared confidentially. Unless otherwise permitted by the confidentiality agreement or required by applicable laws or regulations, the CRA and its employees should not disclose confidential information in press releases, through research conferences, to future employers, or conversations with investors, other issuers, or other persons, or otherwise.*

The Treasury Associations strongly endorse this point.

3.11 *Where a CRA is made aware of non-public information of the kind required to be disclosed under applicable laws and regulations, depending on the jurisdiction, the CRA may be obligated to make this information available to the public. However, prior to doing so, the CRA should indicate to the issuer its intent to release this information and permit the issuer to immediately disclose this information itself. The timeframe a CRA should provide an issuer to make this disclosure should be limited.*

The Treasury Associations believe that issuers should abide by disclosure rules applicable to them. However, the policing role envisaged for CRAs in this item is wholly inappropriate and damaging to CRAs and to the quality of their ratings and to the market. The relationship of trust which is important to proper and complete disclosure by the rated issuer would be severely diminished, with the likely outcome of reducing the amount of information disclosed to CRAs. This would undermine the value of solicited ratings.

The Treasury Associations strongly recommend that 3.11 be deleted from the *Code* in its entirety.

Furthermore, information of a type normally disclosable may not be disclosable under exceptions included in a relevant jurisdiction's regulations or under discretion residing with the appropriate regulator. It is not appropriate for a CRA itself to make decisions in such cases. Accordingly, the following addition to 3.11 is proposed should it be retained:

> *…. However, prior to so doing, the CRA should indicate to the issuer its intent to release this information* *in the absence of new facts indicating that the information is not disclosable,* *and permit the issuer to* *(i)* *immediately disclose this information itself.* ~~*T*~~*(the timeframe a CRA should provide an issuer to make this disclosure should be limited) or (ii) immediately provide reasons to the CRA as to why the information is not disclosable in this case and/or (iii) consult the relevant regulator formally on the actual disclosure requirement in the circumstances actually pertaining.*

For emphasis and clarity, the Treasury Associations believe that 3.11 should actually be deleted.

3.12 *The CRAs should use confidential information only for purposes related to their rating activities or otherwise in accordance with their confidentiality agreements with the issuer.*

And 3.13 *CRA employees should take all reasonable measures to protect all property and records belonging to or in possession of the CRA from fraud, theft or misuse.*

And 3.14 *CRA employees should be prohibited from engaging in transactions in securities when they possess confidential information concerning the issuer of such security.*

And 3.15 *In preservation of confidential information, CRA employees should familiarize themselves with the internal securities trading policies maintained by their employer, and periodically certify their compliance as required by such policies.*

And 3.16 *CRA employees should not selectively disclose any non-public information about rating opinions or possible future rating actions of the CRA.*

And 3.17 *CRA employees should not share confidential information entrusted to the CRA with employees of any affiliated entities that are not CRAs. CRA employees should not share confidential information within the CRA except on an "as needed" basis.*

And 3.18 *CRA employees should not use or share confidential information for the purpose of trading securities, or for any other purpose except the conduct of the CRA's business.*

The Treasury Associations strongly endorse these points.

5.4. 4. DISCLOSURE OF THE CODE OF CONDUCT

4.1 *The CRA should disclose to the public its code of conduct and describe how the provisions of its code of conduct are consistent with the provisions of the IOSCO Principles Regarding the Activities of Credit Rating Agencies and the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies. The CRA should also describe generally how it intends to implement and enforce its code of conduct and disclose on a timely basis any changes to its code of conduct or how it is implemented and enforced.*

The Treasury Associations generally agree with and support this point.

6. Comments on the "separate issues"

6.1. Separate issue 1

6.2. The Treasury Associations would recommend the addition of the underlined language requiring disclosure of methodology changes prior to their going into effect.

6.3. CRAs change methodologies and rating criteria only occasionally and after considerable reflection. A CRA should seek to involve samples of or representatives of affected issuers, investors and other users of ratings in this process of consideration to help ensure that the agency has full information necessary to consider such a change. Reasonable notice should be given to the market before actual introduction of such a change.

6.4. Such changes can destabilise the market, hurting issuers, investors and, indirectly, the economy generally. Speculation on how a proposed change may affect particular ratings can magnify the destabilisation.

6.5. The advantage of a code as opposed to prescriptive law or regulation is that the CRA concerned can use its reasonable judgement as to the appropriate mechanisms and timing according to the nature of the change and the surrounding circumstances. The reputational risk from adverse comment from market participants if the CRA's judgement is reckless or negligent is sufficient to deter such behaviour.

6.6. Separate issue 2

The comments on paragraph 3 of the *Preamble*, on page 5 above, concerning the need for oversight of CRAs are also pertinent to this question.

Regarding the question of outside arbitration, we repeat that commentary by associations of participants in the industry – users and issuers – should be quite sufficient. This assumes that that regulators have taken care to minimise regulatory barriers to entry to new CRAs and that a developed general competition law applies in the relevant jurisdiction.

The following article is intended to illustrate the scope of information which can be provided to CRAs by issuers.

What is provided in any case is determined by the issuer in light of its particular circumstances.

Article taken from
Treasurer's Companion, Managing the treasury function, in The Treasurer's Handbook, 2004,
The Association of Corporate Treasurers, London, pp 250-252

Corporate credit ratings: what information to give a credit rating agency?

Which agencies?

These comments apply to credit rating agencies (CRAs) providing 'solicited' ratings and subject to a confidentiality agreement in respect of identified material/price sensitive information.

What is not disclosable to the agency?

The key is that the agreement with the CRA must impose a duty of confidentiality on the agency in respect of identified un-published price-sensitive information. Subject to this, market practice is for free disclosure to CRAs. The main CRAs are happy to explain their arrangements to ensure that they can honour the contracted confidentiality obligations.

Internationally, Principle 4 of the IOSCO Principles for CRAs[1] deals with the need for confidentiality and the comment in the accompanying report[2] explains that 'The principles also are designed to encourage issuer disclosure and communication with CRAs'.

In the US, the SEC's rules on selective disclosure of 'material information' about companies[3] (Regulation FD) provide an explicit exemption for the CRAs[4]. There is in any case a general exemption for disclosure under a confidentiality agreement[5].

In the EU, under the Market Abuse Directive, disclosure of information likely to have a 'significant effect on the prices' of the financial instruments or related derivative financial instruments is permitted if the recipient 'owes a duty of confidentiality'. MAD implementation is not finalised at the time of writing.

In the UK, the Financial Services Authority acknowledges that local market practice is for disclosure of price sensitive information to CRAs under a confidentiality agreement, although it is, strictly, against the Listing Rules[6]. In the consultation on the listing régime being undertaken by the FSA at the time of writing[7], the FSA again notes the market practice. It goes on to say it will issue a clarifying note once MAD implementation is finalised.

What to provide?

Some CRAs will give ratings based merely on a statistical analysis of the published information about the company. With a solicited rating, the CRA has access to top management of the company and to non-public information. That should lead to more appropriate and more stable ratings, and so a lower cost of capital for the company – which is what it is paying for. Best practice is for CRAs to distinguish 'public information ratings' whenever shown; better practice would be to similarly mark solicited ratings where access to management and information has not been satisfactory[8].

While CRAs normally do a good job of handling information, companies should not assume that information provided has been digested, rather than filed. Or that the

1. 'Principles Regarding the Activities of Credit Rating Agencies', IOSCO, September 2003
2. 'Report on the Activities of Credit Rating Agencies', IOSCO, September 2003
3. 'Selective Disclosure and Insider Trading', Release No. 24-43154 (15 August 2000), 65 FR 51716 (August 24, 2000).
4. 'Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets, as required by S. 702(b) of the Sarbanes-Oxley Act of 2002', US Securities & Exchange Commission, January 2003 (SEC Interim Report) explains in note 60 p22, that with the 'widely available publication of the rating… the impact of non-public information of the creditworthiness of an issuer is publicly disseminated, without disclosing the non-public information itself'.
5. Reg FD (17 CFR 243.100-243.103). Both exemptions are in 100(b)(2). A rating agency here is an 'entity whose primary business is the issuance of credit ratings, provided the information is disclosed solely for the purpose of developing a credit rating and the entity's ratings are publicly available (fourth exemption)'.
6. Financial Times, 30 August 2002
7. Review of the listing regime, Consultation Paper October 2003
8. See ACT response (www.treasurers.org/ actcommentssec.pdf) to the SEC's Concept Release: Credit Ratings under the Federal Securities Commission, [Release Nos. 33-8236; 34-47972; 12-03] RIN 3235-AH28, June 2003

basic information provided when a first rating is made or when a matter first became important has been retained on file and read and understood by successive generations of analyst. Or that the analyst has explained it satisfactorily to the other members of the 'rating committee' in the agency. Some prodding by the company may be needed over the years[9].

■ Information for an initial rating

Before starting, look to see if the CRA rates similar companies. Read the rating reports. If there are important factors distinguishing your company from others in the industry, resolve to make them clear.

The easy part is to provide all relevant publicly available information about the company. Care is needed even here. For example, there will be a lot of financial information: if there are particular accounting conventions/impacts affecting the company's business, provide covering explanations (even re-presentations) with the material – don't let the analyst form false impressions at the outset.

In all of this, you'll find the rating CRA's description of its methodology for corporate rating on its website helpful. They usually set out their favourite ratios, based on one GAAP or another – and if you are unclear how your particular company's figures would be treated in calculations, meet and talk it through with the rating analyst using actual numbers from your published accounts (supplemented by internal analyses if need be) before providing any information – otherwise you will be unsure of where the reassurances or problems may arise.

What else? Companies usually make a major presentation to the rating analysts. Ensure that 'hard copies' of presented material are available with supplementary material as necessary – but all of this must be labelled and indexed or it will be mostly useless.

Careful selection of material for a written submission to the agency in good time before the meeting is important to ensure that the agency brings the right experts and to make best use of costly meeting time.

• 'Macro' factors

Start with the big picture. While the CRA will usually be experienced in reviewing the company's industry, it is unwise to assume their knowledge is adequate, current or correctly selected.

The CRA needs a summary of how the company sees the risk factors affecting its industry, and how they will develop. Capital intensiveness, maturity (technological and market), cyclicality, competition, barriers to entry, substitutes for the industry's products, demand factors, under/over capacity, growth/decline and what is happening to customers, the operating model (national, regional, multi-national or global), environmental impact and 'social responsibility' issues should all be addressed. It may be necessary to deal with separate major product sectors.

A similar run-down on the environment in which the company operates is needed – geographical, social, regulatory and technical/technological.

• 'Micro' factors

With the wider picture established, start to deal with the company's particular situation.

Outline very briefly the management and legal structure of the group.

Cover the market position of key products, ability to differentiate the product and provide competitive advantages, with a review of specific product life-cycle positions and sales/distribution patterns in various geographies.

Relative costs and how sourcing arrangements are advantaged/disadvantaged, implications of single sourcing of key components/materials need to be explored, and the impact of the company's relative size in its industry.

Access to/ownership of necessary intellectual property ('know-how' as well as protectable matter), trademark/ copyright or regulatory privilege must be explained. If the company operates in certain markets under price regulation or particular orders of restrictive-practices courts or competition authorities, point this out.

The principal risks – and opportunities – arising from the story so far must be outlined and related to the industry risk profiles discussed previously. Consider too risks from dependence on particular customers or from particular end uses where the company sells intermediate products.

This leads on naturally to strategy. Outline the company's strategic processes, and go on to current corporate strategy and approach to risk management/risk financing. An important aspect will be the company's balance sheet and cash flow profile and how it is related to the risk financing task. And cover business continuity plans too.

Show how current strategy relates to past strategies – are strategies the Chairman's current whim, or deeply thought out and tested and measured against the real world and a range of future external developments?

If they are not already clear, outline the main drivers of profitability and (with emphasis) cash flow.

Provide copies of the company's business plan, a commentary on any divergences between last year's plan and this year's, and on actual variances. If there are identifiable risks or developments ahead, model their effects and how management will react to deal with these changes. It it is not self-evident, explain the link between the business plan and the strategy.

The CRA's evaluation of the management's abilities and the suitability of the management structure will be important to the eventual rating. Partly derived from the strategic expositions given, the evaluation will also look at the management's track-record: what does the strategic record show? Set it out for the agency: has the business been on an improving track or a muddled/declining one (operationally as well as strategically); has there been delivery of past strategic plans? How has the company performed against previous shorter-term plans; how has it coped with previous unexpected developments with

9. Rated company frustration with failure of rating agencies to retain information provided has been a feature of comments to regulators in 2003. France has introduced a requirement for rating agencies to retain some information for 3 years.

significant impact for good or ill? The rating attempts to be forward looking so it is impossible to overstress how important it is that the agencies understand and respect the management's approach.

Cash flow is inevitably important. In presenting past and projected financials (after the first delivery of published information), ensure that cash flow is highlighted, together with the quantitative aspects of the major cash-flow drivers previously identified. The CRA's favourite ratios will look at cash-flow coverages as well as conventional measures of gearing. Trends in the ratios will be important. The impact of financial transactions (share issuance, share buy-backs, etc.) must be made clear, especially in projections.

Take further the discussion of the balance sheet under 'risk financing' previously, explaining the overall approach to the balance sheet, target duration of debt, etc. as well as dividend policy/objectives.

Consider the impact of the legal structure of the Group on rated obligations (structural subordination) as well as their formal priority/subordination in the issuing company/guarantors and the impact of, for example, exchange controls, controls on inter-company transactions etc. which may shut off obligor companies from resources elsewhere in the Group.

Consider contingent liabilities – those noted in the report and accounts and those not so mentioned. Pension and medical benefits and environmental obligations can loom large here.

Set out the company's 'strategy for financial mobility': how aggressive is gearing (however defined); how flexible are capital/major revenue project expenditures; how disposable/re-deployable are assets; how strong are banking relationships; how fragile are roll-overs of drawn facilities; what multi-year facilities are un-drawn – and what might make them unavailable for drawing; how receptive might equity markets be (given that in this context some corporate stress is assumed)?

The treasurer, who will be the main on-going routine contact for the CRA analyst, needs to be on top of all of the foregoing – but then (s)he should be anyway as part of the general responsibilities for financial strategy. By planning the presentation/meeting carefully, (s)he can make best use of the time of top management colleagues.

Finally, when you let the analysts ask their questions, you will find that there are aspects you have not covered at all or which require further explanation. It is vital that the management team do not blow it all away at this stage. Giving wrong answers off the cuff can weaken the excellent impression built up so far. A good team will be able to give full, correct answers immediately to some questions – but follow these up in writing after the meeting. For other questions, while pointers can be given immediately, analysis or research may be needed and a written answer be given later. There is no shame in that – credit analysts inevitably look at the world through different eyes from businessmen and their worries are not always top of mind for company executives, even the treasurer.

It can also be useful to take the analyst to see convenient important or example company sites, etc. Seeing the attention to hygiene in a food or electronics factory or the application of unique technologies or the differentiation in use of the company's products in the real world can give reassurance for which there is no substitute. But be aware that analyst time is the major CRA overhead and don't do visits just for the sake of it.

■ Information for a continuing rating

CRAs will need updates on all the above as developments and changes occur.

Normally, analysts are well on top of the job, but careful reading of an agency's rating report on your company may throw up matters to focus on. Sometimes they can be minor misunderstandings by the analyst or they may be important. Sometimes, while you believe the analyst has understood something, it is clear that (s)he has failed to convince the rest of the rating committee.

CRAs usually review formally the ratings annually and this provides an opportunity for updating and dealing with worries and for them to meet and hear from top management again. Try to economise on your top management's time by running through most material with the analyst without them. They can then be brought in for particularly important points and for general questions.

Published information should be provided to CRAs as it is issued.

Minor corporate announcements can be handled similarly and the treasurer should call the analysts to answer any questions and to ensure they are happy. Usually, results announcements would fall into this category.

Major announcements will often be about matters considered in strategic plans. Even in such cases, it is sensible to give the analysts a bit of notice of major announcements and, if need be, access, so that, where possible, they can, after a rating committee, issue a firm 'no change' or a firm change, rather than putting the company on 'credit watch' (perhaps with 'negative implications'). Of course, the company should have thought through the implications of the matter of the major announcement on all the factors relevant to the credit rating as discussed above. Thus the contact with the CRA can be fruitful and use least time when corporate executives, including the treasurer, may be very busy.

Conclusion

Remember that the reason you are paying for a 'solicited rating' is so that the rating analyst has a good appreciation of material matters. Ensure that you get full value in this. And if you allow an inappropriate rating of a listed security to persist by failing to communicate effectively with the agency, reflect on the company's obligations under the securities and market abuse laws and regulations in your country/ies of listing.

10.Donaldson G (1969), 'Strategy for financial mobility', Harvard Graduate School of Business Administration, Division of Research (available in the Harvard Classics series)

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Draft:
Code of Standard Practices for Participants
in the Credit Rating Process

Extracted from the Exposure draft consultation document published by the Treasury Associations, April 2004,

Full text available on the Treasury Associations' web-sites (listed on page 2, above) in English and in French

Introduction

Credit rating agencies (CRAs) play an important role in the efficient operation of global capital markets. In addition to any credit analysis done internally, investors depend on the CRAs to analyze all public information and any non-public information the agency has gathered about a company to form a meaningful assessment of the creditworthiness of the company. These ratings, which are commonly paid for by the issuers, are used by individuals, professional investment managers, and corporate finance professionals when selecting securities for themselves or their organizations and by financial institutions when determining whether to lend to a prospective borrower and, if so, at what terms. CRAs also play an important role for companies when evaluating counterparties for financial transactions, in evaluating actual or potential suppliers or customers for non-financial goods and services, and in similarly evaluating partners, collaborators, or joint venture prospects.

… [Material omitted] …

We note the publication by the International Organization of Securities Commissions (IOSCO) of principles for the regulation of rating agencies[9] and generally support those principles. We believe that regulation should only provide a minimal fail-safe framework for CRA regulation and that the more flexible and adaptable industry code of standard practices must play a complementary role to such regulation.

The Associations look forward to discussing these concepts with CRAs, investors, intermediaries, issuers, regulators and other interested parties.

[9] http://www.iosco.org/news/pdf/IOSCONEWS59.pdf

Regulatory Recommendations

1. In jurisdictions where regulators grant recognition or approval to CRAs, the regulators should strive to eliminate unnecessary regulatory burdens and barriers to entry.

    1.1. Regulators should establish and clearly communicate simple, stringent but attainable criteria that CRAs must meet in order to be recognized or approved. These criteria, along with documented processes and procedures, will eliminate unnecessary regulatory barriers to entry into the ratings market and may stimulate new competition.

    1.2. The criteria that CRAs must meet to receive regulatory approval should be based on whether the agency can consistently produce credible and reliable ratings over the long-term, not on methodology. The determination of whether ratings are credible and reliable may be based on market acceptance, quantitative analysis, or other methods developed by relevant regulators.

    1.3. The criteria for recognition should also require a CRA seeking regulatory approval to document its internal controls designed to protect against conflicts of interest and anti-competitive and abusive practices and to ensure against the inappropriate use of all non-public information to which rating agencies are privy.

    1.4. Regulators should periodically review each recognized CRA to ensure that it continues to meet the recognition criteria.

    1.5. It is unlikely, at least in the short-run, that a newly-recognized CRA could displace an established CRA or make it practical for an issuer to not receive a rating from one of the established CRAs. However, with additional competition or even the threat of additional competition resulting from the removal of barriers to entry, regulators should allow market forces to determine the appropriate frequency of rating reviews, acceptable methodologies, appropriate staffing levels and qualifications, and other points about which there is no wide agreement.

    1.6. Regulators should not prescribe methodologies that CRAs may use, but require that each CRA document and adhere to its chosen, published methodologies, while recognizing

that many judgements are involved in arriving at ratings other than purely statistical ratings.

1.7. Because of their access to non-public information about the companies they rate, regulators should require CRAs to document and implement policies and procedures to prevent the disclosure of non-public information to outside parties that might benefit from this information.

1.8. In cases where a CRA is a parent, subsidiary, division, joint venture partner or affiliate of any organization that might benefit from non-public information, regulators should require that the CRA document strong firewalls that prevent the disclosure to or use of non-public information by these related or affiliated businesses or their personnel.

1.9. Regulators should prohibit, for a reasonable period of time, analysts and other CRA staff privy to non-public information from working in positions in securities markets or as journalists reporting or commenting on those markets such that they might benefit from this information.

1.10. Regulators should not stipulate a frequency (e.g., annually, semi-annually) with which CRAs must update ratings, but require agencies to disclose the date of the last formal review and when they last updated each rating.

Rating Agency Code of Standard Practices

2. Credit rating agencies should take steps to enhance the transparency of the rating process.

   2.1. Each CRA should widely publicize its methodologies on a periodic basis and prior to any changes in such methodologies.

   2.2. While recognizing that all credit ratings, apart from purely statistical ratings, involve matters of judgement, a CRA should document and adhere to its published methodologies.

   2.3. Each CRA should widely publicize any changes in its methodologies and allow a short period for public comment to the agency prior to the release of any rating announcement that might be the consequence of these changes.

   2.4. Each CRA should publish the definition and historical default rates of each rating symbol it uses.

   2.5. Each CRA should provide a guide to the methodology applicable to each company it rates prior to the assignment of a rating and preceding the implementation of any changes to the methodology.

   2.6. CRAs should publish information on the qualifications and experience of the analyst assigned to a company, as well as the sector(s) and other companies this analyst covers. This information should be updated from time to time as necessary.

3. Confidential information gathered by CRAs during the development of ratings should be protected and not otherwise be publicly disseminated.

   3.1. Because of their access to non-public information about the companies they rate, CRAs should document and implement policies and procedures to prevent the disclosure of non-public information to outside parties that might benefit from this information.

   3.2. In cases where a CRA is a parent, subsidiary, division, joint venture partner or affiliate of any organization that might benefit from non-public information, the CRA should

document strong firewalls that prevent the disclosure to or use of non-public information by these related or affiliated businesses or their personnel.

3.3. Analysts and other agency staff privy to non-public information should be required, in so far as is consistent with applicable law on employment and restraint of trade, to sign a pre-employment non-disclosure agreement that prohibits them from using their access to such information in future employment in securities markets or as journalists reporting or commenting on those markets such that they might benefit from this information.

4. Credit rating agencies should establish and document policies and procedures to protect against potential conflicts of interest.

4.1. CRAs should have an ownership structure that is not likely to create opportunities for conflicts of interest to arise.

4.2. There should be strong firewalls between rating analysts and agency staff responsible for raising revenue from solicited ratings.

4.3. There should also be strong firewalls between rating analysts and staff involved in providing rating advisory services.

5. Credit rating agencies should clearly distinguish between solicited and unsolicited ratings and disclose when a rating was last updated.

5.1. CRAs should disclose whether each rating was solicited or unsolicited, and whether the issuer participated in the rating process. Whether a rating was solicited or unsolicited should be disclosed each time a rating is published.

5.2. CRAs should disclose whether a rating is based purely on statistical analysis of published information, statistical analysis of published information confirmed through conversations between a qualified analyst and the issuer, or analysis of published information and non-published information gathered during discussions between the CRA and the issuer.

5.3. CRAs should disclose when they last conducted a full review with the issuer and when each rating was last updated.

CRAs should conduct a full review with each rated issuer no less than annually.

6. Rating agencies should improve communication with issuers and the market.

6.1. Prior to public release, issuers should be given an opportunity to review the text of any rating action affecting their securities to ensure the accuracy of reported information and to remove any non-public information erroneously included in the text.

6.2. The CRA should disclose to the issuer the key assumptions and fundamental analysis underlying the rating action, as well as any other information that materially influenced the rating action and that could influence future rating actions.

6.3. Any financial figures that are restated by CRAs in public releases should be fully explained to the issuer and reconciled with the public figures reported by the issuer in its financial reports or other published information.

6.4. Long-term and short-term rating actions should be independent and treated as such, with all disclosure and communication requirements and rights of appeal applying to each rating.

6.5. As the analyst's recommendation can be called into question and overridden by members of the rating committee, issuers should have an opportunity to provide feedback to the rating committee on key assumptions and fundamental analysis, as well as any other information that may have materially influenced the rating action.

6.6. CRAs should commit to completing the rating process in a timely manner with consideration given to any stated issuer intentions to issue debt or otherwise access the capital markets. When an issuer communicates to a CRA its intention to access the capital markets without a corresponding request for a new rating, CRAs should avoid any unnecessary rating actions that could hinder the issuer's ability to effectively complete its capital markets operation.

6.7. Within five business days of a rating action, an issuer should have an opportunity, at its own cost, to appeal a rating or an outlook to a new group of analysts, who should meet with management and have access to previously-gathered

company information. The result of this appeal should be published as soon as possible, but no later than six weeks following the publishing of the appealed rating.

6.8. Information provided to the CRA during the rating process and in regular meetings should be recorded by the agency, retained and made available to ratings analysts that may later be assigned to the company. As the principal rating agencies normally seek to rate through an economic cycle, records should be retained for at least that period as the agency understands it and some fundamental, structural information should be retained permanently or until it ceases to be relevant. During each formal review of an issuer, CRAs should confirm whether the information on record is still applicable or requires updating to ensure that the CRA is not rating based on outdated information.

6.9. CRAs should be expected to respond to issuer concerns about their rating in a timely and serious manner.

Issuer Code of Standard Practices

7. **Issuers should commit to cooperate actively with CRAs when a rating is solicited and to providing information to CRAs that will contribute to the initial and ongoing accuracy and timeliness of solicited ratings.**

7.1. Credit ratings and opinions are forward-looking and involve matters of judgement by the CRAs, and the credibility and reliability of these ratings and opinions are heavily dependent on an issuer's ability to provide adequate and timely information. Therefore, an issuer is responsible for providing information to CRAs that should include:

7.1.1. The issuer's business strategy;

7.1.2. The legal and management structure of the issuer and its parent company or subsidiaries, as well as its management processes;

7.1.3. The risks and opportunities of the issuer's business environment, as well as those peculiar to itself;

7.1.4. The issuer's approach to risk management and financing;

7.1.5. The issuer's financial policies;

7.1.6. Key financial data; and

7.1.7. Any other information or data that the issuer believes will help the CRAs to better understand its particular circumstances and outlook.

7.2. Issuers should provide adequate and timely information, in good faith, regarding any material change in the financial situation of the company.

7.3. Notwithstanding the requirement for full and timely communication to CRAs in 7.2, issuers should hold, at least once a year, a full review with CRAs in order to explain past performance and future prospects on a

horizon relevant, in the issuer's opinion, with the nature of its business(es). In doing this, issuers should allow CRAs to access the appropriate level of management within their organization.

7.4. Issuers should inform CRAs about any corporate actions, including public debt issuances, prior to their launch. Issuers should provide CRAs with all relevant information on these corporate actions in order to allow CRAs to issue their opinion/rating, if any, in a timely manner.

7.5. Issuers should endeavor to address CRAs' questions and requests as quickly as possible and, in case of delayed answers, to inform CRAs accordingly.

7.6. Issuers should seek to react as quickly as practicable to communications submitted to them by a CRA prior to their public release by the CRA. While issuers should, in any case, make reasonable efforts to respond as quickly as possible, the time frame in which companies may review the text should be limited (but not less than four business hours) in order to ensure that investors receive timely information and to minimize the possibility of information leaks.

During this time, issuers should not take any pre-emptive action that would challenge or counter the release by the credit rating agency. In addition, issuers should not take advantage of the delay in the release of the rating action to the market by making any debt issuance other than the refinancing of maturing short-term debt.