European Associations of Corporate Treasurers

Response to

Consultation by the Commission services on Credit Rating Agencies (CRAs) 31 July 2008

Paris, 2 September 2008

European Associations of Corporate Treasurers (EACT)

The EACT brings together the national associations of corporate treasurers and financiers within countries belonging to the European Union.

Contact details are set out at the back of these comments (page 23).

Member Associations have variously consulted their memberships through their relevant committees and working groups, magazines and e-mail bulletins.

Credit rating agencies are very important for our members who work for both issuers and investors and use of credit ratings for other purposes too.

Our members seek the availability of a wide range of types of credit rating from a sufficient number of CRAs, widely accessible and at a reasonable price to the paying customer.

We welcome the opportunity to comment.

Our comments are set out as:

- I. General comments which apply broadly to the proposals or apply to a number of the provisions or to the consultation as a whole (page 2)
- II. Specific comments on the draft directive/regulation (page 8)
- Appendixes (page 16)

This response is on the record and may be freely quoted with acknowledgement. Where we have identified any third party material you may need to obtain permission from the source[1].

[1] In several places we quote from the Code of Standard Practices for Participants in the Credit Rating Process published by international treasurers associations and that document itself may be freely quoted with acknowledgement.

I. General

I.1. Credit ratings

I.1.1 Ratings in the more traditional sovereign and corporate ratings sectors appear to be going on without problems. The nature of the client base and the relationship with issuers mean that there is in practice very little of the kinds of potential conflicts of interest arising from the principal "issuer pays" nature of much credit rating agency revenue. It is important not to cause disruption or to add significant cost or materially to reduce competition among rating agencies in sovereign and corporate ratings.

I.1.2 Problems have been confined to those arising in and from the ratings of structured products. Here the relationship with issuers, if anything, exacerbates the potential conflicts of interest previously referred to.

I.2. Regulation

I.2.1 The proposals the subject of this consultation would be a radical extension of regulation. They need to be justified by a manifest mischief to be addressed. Proposals need to be appropriate and proportionate responses. As far as can be foreseen, they should not have material unintended (negative) consequences.

I.2.2 We commend to the Commission services the "Regulatory Recommendations" in the Appendix at the back of this response and taken from the 2004 Code of Standard Practices for Participants in the Credit Rating Process[2], issued by The Association of Corporate Treasurers (ACT), London, England[3], The Association for Financial Professionals (AFP), United States[4], and the Association Française Des Trésoriers D'Entreprise (AFTE), Paris, France[5], with the support of the International Group of Treasury Associations[6] and Euro Associations of Corporate Treasurers[7].

We are surprised that the Commission services' proposals are so extensive. They seem to descend, in some ways, into attempts to micro-manage rather than to regulate reasonably. As a "level 1" proposal they are more detailed than we would expect a "level 3" proposal to be.

They seem to take a narrow, fixed view of credit ratings and CRAs rather than to recognise the existing and potential variety in size and types of rating agency with varying outputs, methods of operation and contractual relationships with interested parties. This is very limiting for competition and innovation.

I.2.3 There seem to have been only limited market failures as far as CRAs are concerned and limited measures would serve to deal with those. The most effective corrective is the impact of recent events on credibility of ratings (of

[2] Available at http://www.treasurers.org/node/3105 at page 1.
[3] www.treasurers.org
[4] www.afponline.org
[5] www.afte.com
[6] http://www.igta.org
[7] Since re-named the European Associations of Corporate Treasurers, http://www.eact.eu.

particular types) and certain agencies and so on demand for those ratings and on CRA revenues. This market effect is already causing the needed behavioural changes among CRAs without extensive interventionist new regulation.

I.2.4 Limited, principles-based regulation of CRAs might be beneficial. The detailed, rules-based draft seems to be almost wholly inappropriate. It would produce a much less useful, but much more expensive, ratings industry. It would lead to less potential competition between rating agencies. This would be to the disadvantage of issuers and investors and other ratings users and to the economy as a whole.

I.2.5 Where action is more necessary and urgent is in the education of some users of credit ratings. Some users seem, for example, to have used default ratings as proxies for indicators of liquidity or market valuation or loss given default. Some users have abdicated their own evaluation of whether particular investments are suitable for them or for the purpose intended. In times of economic growth it is easy for investors to lower their attention to key investment criteria.

Rating agencies are themselves taking action to educate users. We see that in our own sector as they work with treasury associations to reach our members – although we doubt if our members have been among those misusing ratings.

I.2.6 In some cases, user misuse of ratings may have been encouraged by regulation of investors. This may be seen, for example, in the lack of attention to liquidity in capital adequacy provisions. Regulatory reform in these areas to at least remove the perverse incentives could be very beneficial.

I.3 International aspects

I.3.1 Given the international reach of financial markets and operation of some credit rating agencies and the range of geographic markets into which our members issue as well as invest, we are concerned that at this stage there is no review or discussion of the wider international regulatory scene as relevant in this area. The consultation has been launched without waiting for the benefit of the output of the work of the IOSCO Technical Committee on the possibilities of enforcement of the IOSCO Code Principles.

The US has moved unilaterally in this area and we read that other jurisdictions, such as Australia and Japan, are also considering regulation. This risks adding confusion and costs.

I.3.2 We do not question the right of jurisdictions to act but believe that it is essential that there be coordination between them so as to ensure that they do not introduce conflicting requirements, even at the detail level, especially given the necessarily extra-territorial application of many requirements. The consultation document does not even discuss how the proposals will interact with the existing US requirements or those elsewhere. That is not to imply that the EU should be subject to or take second place to US regulation. But given that there are usually several ways of achieving an objective, care to adopt ways which do not add unnecessarily to costs or compliance difficulties or restrict competition is in everyone's interest.

I.3.3. The proposals do not make clear if/how they apply to ratings made available by CRAs with no connection with Member States except that, for example, their website with ratings is available and residents of Member States sometimes refer to it before buying securities issued, listed, etc. outside Member States. Extra-territoriality effects need careful consideration.

I.4 Agencies as companies themselves

I.4.1 The proposals seem to treat agencies as large, highly profitable firms, easily able to absorb unquantified increases in operating costs.

Treasury associations have pressed over the years for removal of barriers to entry to the market by new credit rating agencies. New agencies may have new business models and are likely to start small. It takes time to build up a list of rated instruments/ obligors. It takes time to build up a list of fee paying clients, whatever the revenue earning model.

I.4.2 We urge the Commission to "think small first" and to weed out from the proposals non-essential provisions which unnecessarily reduce the chances of CRAs successfully setting up and competing with the established firms.

I.5 The rating judgement

I.5.1 We are concerned that the proposals rather assume that the generation of a rating is a purely mechanical output from consideration of the inputs according to the appropriate (published) model.

This can be true for some credit rating agency models which use solely inputs from, for example, published accounts, perhaps supplemented by reports of whether the rated entity/guarantor pays suppliers promptly or has had courts enforcing payments against them[8].

Of course, CRAs need to select an evaluation model which is appropriate for the obligor, the industry, etc. This requires the exercise of judgement.

But the major global CRAs globally have generally, for non-structured obligations, used a model which overlays statistical analysis with judgement about the obligor and/or guarantor – its strategy, general circumstances, management, etc. In many ways that judgement is what the paying client is paying the agency for.

We believe it is essential that any regulation preserves the independence of *judgement* which is a major selling point of a rating agency and much valued by users of ratings.

I.5.2 We support the intent behind the comment in section 1 of the Introductory remarks that the draft provisions "… do not interfere with the content of ratings, for which the CRAs retain full responsibility". We are concerned that this may not be achieved. The independence of the rating judgement should

[8] For example the credit rankings published by Dun and Bradstreet.

be clearly specified in the provisions. This is covered in the US regulations which provide an appropriate model[9].

We see as a potential source of mischief the wide discretion given to regulators and the many points which seem to permit regulators to interfere in the rating judgements. This is discussed further under Authorisation, supervision and enforcement at 1.7.5 and 6, page 6, below.

I.6 Obligors

The provisions tend to assume that the obligors and/or guarantors will be companies. As worded the provisions generally and rightly apply for all of them whether regular corporate issuers, special purpose vehicles for structured credits, governments, national or local or agencies, international bodies established by treaty or other legal persons in general.

The draft text should be reviewed to ensure the intent is reflected in the wording.

I.7 Authorisation, supervision and enforcement

I.7.1 This topic raises many questions.

I.7.2 Some of the member organisations of the EACT would favour a third alternative structure rather than the two proposed: a single EU level regulator of rating agencies, without the residual role for national authorities. This would give a clear “one stop shop” for rating agencies throughout the Union.

I.7.3 Other EACT member organisations do not believe that creation of a unitary supervisory body at EU level for credit rating agency purposes as above or as in the Commission services’ proposal would be appropriate at this time. A much greater degree of both financial market integration and adaptation of local enforcement and legal process would be an essential pre-condition.

These members believe that a shift from a Member State basis of financial services/markets regulation to an EU wide basis in general raises many issues which need to be considered widely and at length by the community at large and by each individual Member State. It should not be embarked upon lightly and particularly not in a measure which is being advanced as urgent.

They believe that national authorisation and supervision, as with other financial services is an appropriate, available option at the present time – even though it is, of course, a “least worst” solution.

I.7.4 Coordination through CESR is convenient, even though ratings or equivalent are also relevant to CEBS and CEIOPS. CEBS and CEIOPS should be

[9] Paragraph (c)(2) of Section 15E of the Securities Exchange Act of 1934 as amended:
"Limitation. The rules and regulations that the Commission may prescribe pursuant to this title, as they apply to nationally recognized statistical rating organizations, shall be narrowly tailored to meet the requirements of this title applicable to nationally recognized statistical rating organizations. Notwithstanding any other provision of law, neither the Commission nor any State (or political subdivision thereof) may regulate the substance of credit ratings or the procedures and methodologies by which any nationally recognized statistical rating organization determines credit ratings."

consulted appropriately by CESR and also able to comment to CESR on their own initiative even where they have not been consulted.

I.7.5 We are concerned by the wide scope of host-country Member State competent authorities retaining the "competence and right to take action, notably in order to protect interests on the territory of their Member State". This needs careful circumscription to avoid abuse. The "interests" to be protected need careful consideration. Protection of orderly markets and avoidance of fraud may be appropriate. Protection of the credit rating of a particular entity is not.

I.7.6 "Enforcement" of CRAs' following their published methodologies sounds at first glance to be a "good thing". However, experience shows that authorities can be tempted to intervene – in private discussion with rating agencies or by public rhetoric – to influence the rating of national champions or companies or agencies in the public eye. Opportunities for this sort of irresponsible action should be minimised. Authorities' opportunity to act could be limited to cases which, prima facie, satisfy a strong test. Restriction to cases where gross negligence, recklessness, malice or the seeking of pecuniary advantage is suspected would be appropriate.

I.7.7 *Authorisation process: designation of home Member State*

Choice of home Member State could be an important factor for a CRA, especially a new or growing one. Accordingly, we suggest that a CRA be able to propose a home Member State when seeking authorisation. There should be a strong presumption that this request will be granted. CESR or the Union agency in determining the home Member State should only be able to overturn the presumption on very strong and stated grounds.

I.8 Reactivity of ratings

The provisions seem to assume that credit ratings should change to reflect changing market conditions. This is not always right.

It might apply to credit ratings marketed as being so reactive. This could, for example, apply to a publisher of market implied ratings which can change with changing credit spreads for an obligor or class of obligors very rapidly – seemingly with every change in the wind.

However, credit ratings stability is a valued property of many ratings. Such ratings look at the likely effect of the economic cycle on an obligor and, other things being equal, such ratings would not vary with normal cyclical market patterns.

This is an example of the failure of the proposed provisions to recognise the existing and potential scope for different types of rating. They should be examined to ensure they don't restrict the existing range or new developments. Restriction would have the effect of reducing competition and protecting incumbent firms at the expense of new firms with different propositions.

I.9 Publication of credit ratings

The provisions seem to assume that credit ratings will be made public. If an investor, an issuer, or anyone else (for example a prospective joint-venturer or supplier) wishes to pay a rating agency to provide it with a rating of a company/government/agency/etc. why should it not be able to do that with the rating remaining confidential to it?

I.10 Consultation process

I.10.1 We regret that more time has not been allowed for this consultation especially given the importance of the topic. The short time allowed has, of course, coincided with the principal northern hemisphere holiday periods. It is a difficult time for membership bodies such as the national treasury associations to consult their members and to coordinate internationally through the EACT

1.10.2 We acknowledge that the consultation itself seeks information on the impact, cost and benefits of the proposals. Nevertheless, we regret that no draft impact assessment was published with the proposals. We hope the Commission services will publish a draft impact assessment for comment before the drafting/legislative process goes on to the next stages.

1.10.3 As explained above (page 2), we do not see a market situation which calls for a rush to legislation.

II. Comments on the draft Directive/Regulation

Note: We do not generally repeat here the General comments made above that have broad application to the draft Directive/Regulation and imply re-casting of several sections. As an example, this applies to those requirements which presume a large organisation with many staff, which would tend to raise both costs and the barriers to entry to the market for new agencies.

Numbering in this section follows that in the draft Directive/Regulation.

Preamble

10. *This comment on (10) refers to CRAs which are not purely statistically driven, where there is direct contact with the obligor and considerable judgements are involved.*

One of the strengths of an established credit rating agency is that it has staff that will have built up knowledge of a company, industry or sector over time. They will have seen how firms are affected at different times in the economic cycle and product life-cycle, where the company is in strategic terms, integration of acquisitions, long-term investment programmes, new product developments, etc.

Also, there is a significant cost to a rated obligor/guarantor in helping a new credit rating analyst become familiar with the firm, sector, industry etc. and how it may be differentially affected by real-world events.

Recognising the need for some rotation and the typical length of the economic cycle, we see advantage in the model whereby, absent other staff movements:

- the junior analyst expects to become the senior analyst and
- the senior analyst expects to move on but
- to remain a member of the rating committee which reviews the analysts' recommendations.

This would give an individual, perhaps, a main involvement of four years or so with some involvement in the preceding and subsequent four years too.

12. *This comment (12) refers to CRAs which are not purely statistically driven, where there is direct contact with the obligor and considerable judgements are involved.*

We consider it important that a credit rating agency not be required to conduct independent testing of data provided to it – the costs would be a severe burden on those paying for the rating.

The CRA should of course react if, on its face, information is wrong or conflicts with other information received, if necessary amending or

withdrawing a rating. It should do the same if it feels that information provided is insufficient (or it could, in this case, switch the rating to a "public information" rating).

The CRA contract where the obligor is the client can perhaps call for information to be provided in good faith. To go beyond that is to impose costs greater than the system can sustain.

To illustrate industry practice and good practice, we append two items:

- the code of conduct for rated issuers published by the international treasury associations in 2004 (page 17, below) and
- the article "What information to give a credit rating agency?" from the International Treasurer's Handbook published by the Association of Corporate Treasurers.

We see no need for any of this to be incorporated in law or regulation.

The persons who may suffer if a CRA is given false information are mostly those who used the rating as part of the information used in evaluating the suitability of the investment. They cannot gain rights under any contract between the CRA and the obligor.

It is important, if honest credit ratings are to be available at reasonable cost, that ratings be recognised as opinions which give no rights to any third party (except potentially in case of fraud, market abuse, etc.).

17. (17) assumes that the credit rating is a solicited rating with involvement of the obligor/guarantor. All drafting should ensure that it is clear where, as in this case, the provision does not apply for a "public information" rating where there is no dialogue with the rated entity etc. Such ratings should always be distinguished from ratings with involvement of the obligor/guarantor.

18. We do not see advantage in the availability of a central repository as described. If there is demand it will be met by information providers such as Bloomberg, Thomson/Reuters and the Financial Times. In any case, as different types of rating measure different things it can be dangerous to compare ratings without recognising that point, and this may be encouraged by a central repository.

Article 1

Definitions

1.(2) We are concerned about the position of a firm which publishes credit ratings as a part of another business. For example several commercial banks have been known to sell their internal credit ratings to other banks and firms which thereby save the analytical costs. One can see a number of firms issuing credit ratings ancillary to some other business. This needs consideration as to the applicability of regulations.

Article 7

Persons who effectively direct the business

There seems to be a failure to understand the role of the non-executives on the board of a company. Non-executives are supposed to bring their broad general experience to the direction of strategy and to the accountability of the executive of the firm and to be in a position to bring about the dismissal of the Chairman or Chief Executive if the need arises. A minority may be experts in some aspect of the firm's business.

It is wholly inappropriate to specify the basis of remuneration for non-executives or to prohibit any linkage to earnings and shareholder return. Among other reasons, directors have fiduciary duties to a company and its stakeholders and provisions such as those proposed would produce irreconcilable conflicts of interest.

What is described in 2. is more that of an advisory committee established (by the board of the company) to advise the executive and perhaps to provide comment to the board on the tools and techniques used by the business. Article 15(3) refers to an "independent committee of the supervisory board or administrative board of the credit rating agency". Such an advisory committee as we suggest here could have that role too.

This needs considerable re-thinking. And extra-territorial effects should be researched and evaluated.

Article 8

Organisation requirements and internal policies

1-4 Sections 1 to 4 of this Article are drafted so as to set objectives for credit rating agencies. The CRAs can develop appropriate mechanisms to meet those objectives. This is an appropriate approach.

5 In 8.5, the style reverts to that of attempted micro-management.

A more ends- rather than means-orientated approach would be better. For example, "A CRA shall establish appropriate supervisory arrangements to monitor the development of the credit rating policy …" without specifying details such as committee organisation.

Article 9

Identification, management and disclosure of conflicts of interest

4. It is necessary to distinguish between
   - the type of structuring process used in setting up structured finance vehicles and
   - the kind of informal dialogue a rated corporate issuer would have with analysts in discussing the firms strategy about the likely impact of planned acquisitions or diversifications and possibly

- a formal rating of a "what if we do a particular acquisition or disposal or reorganisation" nature for which a rated corporate issuer may pay when things get really serious.

There are material potential interest conflicts in the first case. We think there are none in the second case.

And as the credit rating agency will form its own view when when/if the actual event takes place, we think there are only small risks in the third case. Some CRAs make a separate business of this third type of advice – and that can reduce the potential conflicts even further.

It is particularly true as the very high costs to a corporate issuer of changing a CRA mean that there is no incentive for the CRA to indicate a higher rating or even to publish a rating of the event the same as that indicated on the project (which project will rarely be delivered as originally conceived anyway). This is reinforced as corporate issuers infrequently seek new ratings, so there is little "repeat business" to be secured.

Per contra, in the first case – the structured credit – not only is a sponsor likely to have taken soundings with several CRAs and to choose the most favourable rating, the sponsor is (or was in the past) very likely to be a frequent repeat customer. So the potential for conflicts of interest is material.

9.4 should be limited to structured credits or there should be a "carve out" for the type of corporate issuer (or comparable government agency etc.) activity referred to above.

Article 10

Employees

4. See our comments above (page 8, Preamble, 10) on the period for which employees should be involved with a rating.

   As drafted, this would have deleterious effects on both the quality and the cost of credit ratings.

Article 12

Rating methodologies

- We believe there should be a statement here that no part of the directive/regulation is to be interpreted as going to the selection of credit rating methodology, including the use of judgement, by a CRA, provided that the methodology is disclosed if the rating is made public. For a credit rating paid for by an investor for its own use, the methodology and any disclosure thereof is a matter between the credit rating agency and its customer only.
- We believe that, where practicable, rating agencies which publish ratings to the public should consult stakeholders about potential rating changes.

2. It is important to recognise that a credit rating represents the opinion of the provider of the rating. They should not be obliged to "recognise" another

CRA's rating or to justify ignoring it or making their own (different) judgement[10].

3. See our comments above, page 6, on Reactivity of Ratings.
This requires some recasting to recognise credit ratings which seek to achieve a measure of rating stability and so would only respond to changes in financial conditions outside the range considered in establishing the rating.

4. Use of "comprehensive" for the annual review of methodology is too strong. It would add a material cost for no benefit. What is needed is a broad review annually to establish if a comprehensive review or detailed review in some sector(s) or review of the treatment of certain items is needed.

5. Again, the concepts here should apply only where credit ratings are made public.

CRAs should disclose methodology changes, but "immediately" is too strong. Perhaps "promptly" or "as soon as practicable" or "without delay" would be better.

Much of this (5) seems to be an attempt to micro-manage rather than to regulate.

Given that ratings are distributed in many forms – as long-form reports or as a string of symbols in a table, the requirement to disclose methodology changes through the "same channel" is both inadequate and too much. A requirement to publicise would be quite adequate.

We see no need to require review of pre-existing ratings to a particular timetable. "As soon as possible" is too strong – "as soon a practicable" would be quite adequate.

The last part – the requirement to "re-rate" ratings – is wholly unnecessary. A simple review to adjust the rating for the methodological change is all that is needed – a re-rating being more expensive and time consuming.

Article 14

Obligations in relation to the disclosure and presentation of credit ratings

This applies only to credit ratings which are made public and should be confined to such ratings.

1. We see no reason in principle why a credit rating should not be disclosed to a section of the public which pays for the privilege ahead of disclosure to the

[10] In its response to the SEC's April 2007 consultation "Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations" the ACT commented on the same mooted idea:
"On pools, we consider that limiting the ability of any business to undertake or refuse business on the basis of its own judgements is a serious step which should only be considered in the gravest of circumstances. We would expect a rating from any agency to be based on its own methodology and its own research – it should be its own opinion. Differences between agency ratings contain information. If a rating agency uses another agencies work in coming to a conclusion it should be required to disclose that – although it will probably want to make that disclosure in any case."

public in general. This is analogous to the delay in price reporting from stock exchanges for use by non-subscribers.

Secondly, the current common practice whereby the bare rating indicator is made public but the long-form rating including the discussion is available only on a subscription basis seems harmless. Why should it be forbidden?

Practice is that a credit rating agency usually (but importantly, for good reasons, not always) discloses a rating to the rated party a short period prior to intended public dissemination. This can provide opportunity for the rated party to correct errors, etc. It is important not to forbid this.

3. We are supportive of this. It is important not to be diverted by financial intermediaries etc. suggesting that the cost of adapting mandates etc. would be material. Recent events have revealed many investors' poor understanding of credit ratings. It would be an opportunity for the financial services industry to do something about that for those from whom they receive mandates – which they should already have considered under "know you client" and "suitability" provisions in other regulations.

Article 15

General and periodic disclosures

2. Again this should apply only to those credit ratings made public.

We do not understand the term "repository" and consider that a credit rating agency's obligation should be satisfied if it makes the information available on its website.

We presume that the brief rating symbol rating indication is what is referred to here and not the long-form report which is available by subscription. This should be made clear.

3. We do not know what "independent committee of the supervisory board or administrative board" of the CRA is, but make a suggestion under Article 7 above, page 10.

Article 16

Transparency report

1. We see no merit in this proposal.

Adherence to codes is usually voluntary. Probably it is to be applauded. Probably a credit rating agency would like to let its potential clients know it is doing the right thing in these respects as part of its general marketing and sales effort. Often the code will itself provide for disclosure. But why should disclosure be mandatory by EU legislation?

If compliance with a code of conduct is mandatory, some statement of compliance or explanation of non-compliance may be a good thing and such disclosure would normally be part of the code itself.

Annex II Operating Conditions

Section B:

I. Rules on the presentation of credit ratings

This Section seems to apply only to credit ratings which are made public and this should be stated.

2.(a) According to the disclosed methodology of the credit rating agency, a CRA may (at its discretion, importantly) disclose its proposed rating to the obligor and/or guarantor. This is in the interest of helping ensure that the rating is appropriate, mistakes or misunderstandings are eliminated, etc.

In such cases it is just part of the rating process and not something separately to be disclosed. If the proposed (not issued) rating is changed, this is a good thing to have got corrected before publication. A rating change by a committee from the recommendation by the analyst is not publicly disclosed. The situation contemplated in this article is similar.

Furthermore, the consequences for an issuer of a down-rating can be very material and it should (normally) have pre-warning of this. If a listed company, it may need, for example, to make a formal announcement about the consequences or want to make such an announcement to prevent a false market developing.

The practice is covered in the Code of Standard Practices for Participants in the Credit Rating Process issued by the international treasury associations[11] as follows

- In the Rating Agency Code of Standard Practices:
  6.1. Issuers should be given an opportunity to review the text of any rating action affecting their securities prior to public release to correct any factual errors in reported information and to remove any non-public information erroneously included in the text. [12]
- And in the Issuer Code of Standard Practices:
  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

[11] Code of Standard Practices for Participants in the Credit Rating Process, The Association of Corporate Treasurers (ACT), London, England, The Association for Financial Professionals (AFP), United States, Association Française Des Trésoriers D'Entreprise (AFTE), Paris, France, with the support of the International Group of Treasury Associations and Euro Associations of Corporate Treasurers, available at http://www.treasurers.org/node/3105

[12], *Ibid* at page 5.

issuance other than the refinancing of maturing short-term debt. [13]

2(c) If a CRA chooses to issue a sensitivity analysis as part of the service it provides that is fine. Why should it be a mandatory part of its business model that it publish a sensitivity analysis?
This is another example of the proposal's many attempts to micro-manage rather than to regulate.

4 We support the concept of these disclosures.

II. Periodic disclosures

Paragraph below 3:
The definition of "client" should be expanded. It needs to include governments, local government entities, state agencies, bodies established by international treaties etc. – i.e. any legal personality which has a credit rating or issues or guarantees a rated entity or a rated obligation.

[13] *Ibid.*, at page 7.

Appendix 1
Extracts from:

Code of Standard Practices for Participants in the Credit Rating Process[14], issued by The Association of Corporate Treasurers (ACT), London, England[15], The Association for Financial Professionals (AFP), United States[16], Association Française Des Trésoriers D'Entreprise (AFTE), Paris, France[17], with the support of the International Group of Treasury Associations[18] and Euro Associations of Corporate Treasurers[19],

Extract 1: 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 specific 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,

[14] Available at http://www.treasurers.org/node/3105.
[15] www.tresurers.org
[16] www.afponline.org
[17] www.afte.com
[18] http://www.igta.org
[19] Since re-named the European Associations of Corporate Treasurers, http://www.eact.eu.

Extract 2: 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 when the CRA's rating methodology involves access to management and to confidential, non-public information.

   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, update or revise 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.

Appendix II

Extract from:
The International Treasurer's Handbook 2008
Published by The Association of Corporate Treasurers, London 2007, ISBN 1-869819-04-7 (Issue 1 8a): pp 148 ff.

Managing the treasury function

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

Which agencies?

This article applies to credit rating agencies (CRAs) providing 'solicited' ratings and subject to a confidentiality agreement in respect of identified inside/price sensitive information.

What is not disclosable to the agency?

In the EU, under the Market Abuse Directive, disclosure of information likely to have a 'significant effect on the prices' of an issuer's financial instruments or, related derivative financial instruments is permitted if the recipient 'owes a duty of confidentiality'.
In the UK this Directive has been implemented by the FSA as part of their Disclosure Rules which came into effect on 1 July 2005. The previous unofficial practice of disclosure to CRAs is now specifically covered, in that selective disclosure to them while delaying general disclosure is allowed if, under a duty of confidentiality. It is advisable to document this duty of confidentiality in respect of matter falling within the definition of 'Inside Information' by agreements with the CRAs. 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.
The International Organisation of Securities Commissions (IOSCO) issued a Code of Conduct Fundamentals for Credit Rating Agencies in December 2004. In order to encourage issuer disclosure and communications with CRAs there is a section in the Code requiring CRAs to adopt procedures and mechanisms to protect the confidential nature of information shared with them by issuers.
In the US, the SEC's rules on selective disclosure of 'material information' about companies[1] (Regulation FD) provide an explicit exemption for the CRAs[2]. There is in any case a general exemption for disclosure under a confidentiality agreement[3].

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 disclose whether the issuer participated in the rating process and that any rating not initiated at the request of the issuer should be identified as such[4]. Better practice would be similarly to mark solicited ratings where access to management and information has not been satisfactory[5].
The *Code of Standard Practices for Participants in the*

Credit Rating Process issued by the ACT and other treasury organisations advises that issuers should co-operate actively with CRAs when a rating is solicited and provide adequate and timely information[6].
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 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 analysts. 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[7].

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 needs 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 a 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 protected 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 cashflow 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 current Chairman's 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) cashflow.
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.
If 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 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.
Cashflow is inevitably important. In presenting past and projected financials (after the first delivery of published information), ensure that cashflow is highlighted, together with the quantitative aspects of the major cashflow drivers previously identified. The CRA's favourite ratios will look at cashflow 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. Pension and medical benefits and environmental obligations can loom large here.
Set out the company's 'strategy for financial mobility'[8]: 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; and, 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 will 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 an analyst's time is the major CRA overhead and, don't do visits just for the sake of it.

Managing the relationship
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 formally review 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 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 needs 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 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.
Although the analyst is the primary conduit of contact between the company and the agency, it is worth bearing in mind that both the senior management local to the company and the credit committee (whether local or agency head office based) also have an important role to play in determining a rating. Treasurers would do well to ensure that they have some element of relationship with both those areas of the respective agency.

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 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/countries of listing.

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1 'Selective Disclosure and Insider Trading', Release No. 24-43154 (15 August 2000), 65 FR 51716 (August 24, 2000).
2 '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'.
3 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)'.
4 IOSCO Code of conduct fundamentals for credit rating agencies, December 2004, clause 3.9.
5 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.
6 'Code of standard practices for participants in the credit rating process', issued by the ACT, the Association of Finance Professionals and L'Association Française des Trésoriers d'Entreprise on behalf of the International Group of Treasury Associations, March 2005, section 7. See www.treasurers.org/technical/papers/resources/cspfinal_mar05.pdf
7 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 three years.
8 Donaldson G (1969), 'Strategy for financial mobility', Harvard Graduate School of Business Administration, Division of Research (available in the Harvard Classics series).

European Associations of Corporate Treasurers

EACT includes 18 associations of 17 countries of the European Union representing about 4,600 companies/groups and 8,100 corporate treasurers and finance professionals.

ACT, The Association of Corporate Treasurers (UK)	GEFIU, German Financial Executives Institute (Gesellschaft fûr Finanzwirtschaft in der Unternehmensführung e.V.)
AFTE, Association Française des Trésoriers d'Entreprise	HTC, Hungarian Treasury Club
AITI, Associazione Italiana Tesorieri d'Impresa	IACT, Irish Association of Corporate Treasurers
ASSET, Asociacion Espanola de Financieros y Tesoreros de Empresa (Spain)	ÖPWZ, Forum Finanzen (Austria)
ATEB, Association of Corporate Treasurers in Belgium	PCTA, Polish Corporate Treasurers Association
ATEL, Association des Trésoriers d'Entreprise au Luxembourg	SACT, Swedish Association of Corporate Treasurers
CAT, Czech Association of Treasury	SAF, Slovak Association of Finance and Treasury
DACT, Dutch Association of Corporate Treasurers	SCTA, Slovenian Corporate Treasurers Association
FACT, Finnish Association of Corporate Treasurers	VDT, Verband Deutscher Treasurer (Germany)

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The ACT's approach to policy issues is set out in the Policy and Technical Manifesto, www.treasurers.org/technical/manifesto

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