MOODY'S
INVESTORS SERVICE

Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
+44 20 7772 1000 tel
+44 20 7772 5401 fax
www.moodys.com

28th March 2014

Mr Tim Pinkowski
International Organisation of Securities Commissions
Calle Oquendo 12,
28006 Madrid
SPAIN

Dear Mr Pinkowski,

COMMENT ON PROPOSED AMENDMENTS TO THE IOSCO CODE OF CONDUCT FUNDAMENTALS FOR CREDIT RATING AGENCIES

Moody's Investors Service ("MIS") appreciates the opportunity to comment on the proposed amendments to the International Organization of Securities Commissions Code of Conduct Fundamentals for Credit Rating Agencies ("IOSCO Code"). In this regard, we welcome the simplification of the IOSCO Code and the clarity introduced through certain of the amendments. We are concerned, however, that some of the amendments to the Code, as currently proposed, seem to directly contradict important policy principles put forward by the G-20 and the FSB regarding greater clarity about roles and responsibilities of the various market participants.[1] Annex 1 provides a more detailed discussion and our suggested modifications on the proposed amendments to the IOSCO Code.

Broadly, we remain supportive of the IOSCO Code because of its important role in deepening the understanding of the credit rating agency ("CRA") industry in the capital markets. Indeed, since their inception, the IOSCO Principles and the IOSCO Code have been the bedrock of the regulatory requirements for the supervision of CRAs, and they have helped foster understanding of the important but limited role credit ratings play in the market.

With this new proposal, we perceive a departure in the IOSCO Code's original objective. Specifically, it appears that rather than providing a model code that can then be adopted on a "comply or explain" basis by the various participants in the CRA industry, the document is putting forward a more rigid, proscriptive and seemingly compulsory rule set. In its relevant part, IOSCO states, "IOSCO CRA Code only addresses measures that CRAs ***should*** adopt to help ensure that Principles are properly implemented." (*Emphasis added.*)

More substantively, we believe the proposed amendments signal a level of discomfort with the innate *uncertain*, *subjective* and *limited* nature of credit ratings. In particular, we draw your attention to the following three proposed changes that, when taken together, could be perceived by some as an attempt to reengineer ratings as something they are not. In the end, no amount of written text will change the fundamental essence of ratings or the nature of the rating process.

[1] In particular, see the Principles for Reducing Reliance on CRA Ratings, Financial Stability Board, 27 October 2010.

Yet, the more IOSCO attempts through the Code to portray ratings as something they are not, the more it will lead to confusion in the market and undermine one of the Code's primary missions of increasing understanding of the CRA industry.

1. Opinions about an uncertain future

IOSCO has proposed redefining a "credit rating" as an "assessment". By moving away from a definition that includes the word "opinion", IOSCO's proposal may inadvertently promote the false impression that credit ratings are snapshots of issuers or securities' current status, and not uncertain forecasts about the future.

IOSCO argues that while the determination of a credit rating frequently involves subjective judgment, the term opinion has a casual connotation about it, which is inconsistent with the IOSCO CRA Code.[2] IOSCO continues that modifying the definition will require CRAs to establish processes that govern how credit ratings are determined. Notwithstanding our disagreement with IOSCO's interpretation of the word "opinion" as casual, we believe that it appropriately conveys a level of uncertainty about the future that is such an essential part of a credit rating.

A credit rating is based on a consideration of a range of possible future outcomes whose probabilities are simply not known. A common misperception exists that credit ratings are binary – *i.e.*, "pass-fail" or "high-low" – perhaps because bonds ***ultimately*** behave in a binary manner: that is, either they default or they do not default. At the time that MIS forms its credit opinion about any given bond, it is not yet known whether the bond will perform or default. It is simply not possible to predict the future with absolute precision. For that reason, MIS has developed a 21-symbol rating system that reflects our view of the relative future credit risk of issuers and financial obligations in comparison to other issuers or securities. It is not a "pass-fail" system that predicts which issuers or obligations will or will not default, or when they will default. Rather, MIS's rating system communicates an opinion about the probability of an issuer's or financial obligation's risk of default and loss ***relative*** to other issuers and obligations.

Finally, while as forward-looking opinions, credit ratings can distinguish bonds with higher credit risk from bonds with lower credit risk, it is crucial that they not be viewed on an individual rating-by-rating basis, but rather in their aggregate. However desirable, it is not practical for any single opinion to be "correct" or "incorrect" on a case-by-case basis.[3] Indeed, to create the impression that any opinion about the future, including credit rating opinions, should be viewed as rigid statements of fact is to place an inordinate burden on the innate uncertain nature of opinions.

MIS, therefore, strongly suggests that IOSCO revert back to its original definition of credit ratings, and help deepen the understanding that credit ratings are uncertain by nature.

2. Subjective analysis

IOSCO is proposing to redefine ratings methodologies as:

> *the procedure by which a CRA determines credit ratings, including the information that must be considered or analyzed to determine a credit rating and the analytical process to be undertaken to*

[2] See footnote 15, IOSCO Code Consultation.

[3] For example, while the vast majority of Baa securities pay off, certain Baa securities default. Neither result is "wrong" *per se.* But an issuer with a Baa rating whose bonds does in fact pay off will argue that the their securities were rated too low, just as an investor holding the rare defaulted Baa security would argue that the rating was too high.

determine the credit rating, including, as applicable, the models, financial metrics, assumptions, criteria, or other quantitative or qualitative factors to be used to determine the credit rating.

The redefinition of methodologies appears to be removing subjectivity, analytical thought and judgment from credit analysis, thereby transforming it into a rating-by-steps exercise. There are a number of tools currently available in the market that are purely model-driven and do not include analytical thought or adjustments. These measures (*e.g.*, credit default swap indicators) are useful and powerful tools for market participants. They are not, however, credit ratings. Importantly, there is no single methodology for developing credit ratings. Moreover, no methodology should or can capture every single credit relevant factor. Methodologies are not "cookbook recipes", but rather analytical frameworks that provide a coherent and consistent approach upon which analysts can layer their own individual, subjective thinking.

For example, among other factors, our ratings are primarily based on analysis of companies' financial statements, as well as on assessments of management strategies and industry position. MIS's methodologies include consideration of reasonable downside scenarios, as well as more severe stress scenarios, in order to gauge the amount of financial flexibility an issuer may have. By its nature, this is a subjective analysis informed importantly by the experience that our analytical teams bring to bear to each credit.[4]

In the proposed definition of "*credit rating methodology*", the use of the terms "procedure", read together with the rest of the definition to include models and key assumptions, may cause readers to assume that rating methodologies are static, inflexible procedural codifications. They are not. Were they to be treated as such, the ability of CRAs to respond to changing conditions would be severely limited, making them less capable of meeting the demands of a continuously evolving market.

Over time, diversity of opinion would suffer, and the motivation and ability of CRAs to compete on the basis of improving credit analysis and thinking would be materially eroded.

3. Limited role of credit ratings

Credit ratings play an important, but limited, role in the markets. MIS credit ratings are forward-looking opinions that speak only to the relative credit risk of fixed income instruments: namely, their relative probability of default and the potential severity of any financial losses to creditors. MIS credit ratings do not address any other type of risk, such as price, likelihood of prepayment or liquidity risk.[5] Over the past several years, the broader public policy agenda has focused on ensuring that CRAs are very clear about what they are able to do, and the limitations of their role. The proposed amendments to provision 3.1 of the IOSCO Code are demonstrative of this broader public policy initiative.

Certain provisions in the existing IOSCO Code and/or the proposed amendments are inconsistent with the limited role of CRAs. Calling upon CRAs to engage in such activities increases the risk of over-stating the

4. A weather forecast is another form of opinion that provides a relevant analogy. On any particular date, a forecast may predict rain with some probability (e.g. 60%). It either will or will not rain and in some circumstances the forecast will be incorrect. However, the accuracy of a weather forecaster would only properly be judged based on a large enough statistical samples to ensure a valid evaluation of the probabilistic forecasts.

5. Nor is a credit rating a recommendation to buy or sell a bond. For more information on the definition of a credit rating, please refer to the Moody's Investors Service Code of Professional Conduct ("MIS Code"), which is available on moodys.com, or any MIS rating action, each of which is also available on moodys.com

role that CRAs play in the capital markets, which could lead to over-reliance on CRAs and their opinions. Some examples are as follows:

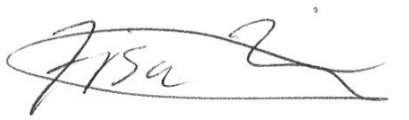
- Section 2.9; requiring CRAs to encourage structured finance issuers to disclose information to the market;
- Section 3.1; requiring CRAs to use "plain language" in their disclosures which should be "easily understood", which could suggest that those disclosures are intended for parties other than financial market professionals, the otherwise traditional audience for credit ratings;
- Section 3.9; opportunity to comment on the credit rating. As worded, this provision could give an indication that CRAs may be subject to the bias and influence of third parties.

We suggest the IOSCO Code further emphasise that CRAs provide only one perspective on credit risk for broader consumption by market professionals, and more importantly that credit ratings should not be perceived as substitutes for information by the issuer or analysis by the investor.

Such an approach will promote the FSB principle of encouraging market participants, including regulators, to do their own analysis and form their own perspective on risk. Ratings can be part of the broader discussion on credit risk, and the more diverse the views the more healthy the debate.

We appreciate the opportunity to comment on the proposed amendments to the IOSCO Code. We would be pleased to discuss our comments further with IOSCO.

Yours sincerely



Farisa Zarin
Managing Director
MCO Global Regulatory Affairs

Annex 1

Set forth below are MIS's suggested edits to the proposed amendments to the IOSCO Code.

1. TERMINOLOGY

1.1 Definition of "Affiliate"

The proposals introduce new expectations for CRAs in regard to affiliates, for example, in the areas of reporting misconduct by employees (section 1.24) and measures to be taken against conflicts of interest (sections 2.14 and 2.18). These provisions, when read with the definition of "affiliate," could be challenging to implement in relation to those affiliates which the CRA does not directly manage or for which it lacks the power to direct or supervise the affiliate's policies, procedures and controls. Accordingly, we recommend that the definition be amended as follows:

"Affiliate" means an entity that directly or indirectly controls, is controlled by, or is under common control with the CRA and over which the CRA exercises management control including the establishment, maintenance, documentation and enforcement of policies, procedures and controls.

1.2 Definition of "credit rating"

As mentioned in the body of our letter, MIS believes the existing definition of "*credit rating"* in the IOSCO Code more accurately reflects that a credit rating is a forward-looking opinion on credit risk only and therefore does not prompt the market to over-rely on credit ratings.

"Credit rating" or "rating" means an opinion ~~assessment~~ regarding the creditworthiness of an entity or obligation, expressed using an established and defined ranking system.

1.3 Definition of "credit rating methodology"

In line with the above comment, MIS is concerned that the use of the term "procedure" as part of the definition of "*credit rating methodology*" indicates that assigning a credit rating will be read as a mechanical process. This definition, when read together with the proposed definition of "*credit rating*", may lead to a perception that rating methodologies are codified, static or inflexible procedures that could limit the ability of CRAs to respond to changing conditions, making them less capable of meeting the demands of a continuously evolving market and decrease competitiveness amongst CRAs. In this regard, we would propose amending the definition to emphasize that methodologies are comprehensive but not inflexible.

"Credit rating methodology" means the ~~procedure~~ analytical framework ~~by which a CRA~~ used by a CRA to assign ~~determines~~ credit ratings, that are predictive of default and/or future expected losses for investors, including the key determinants of credit risk and the qualitative and quantitative considerations that ~~must~~ the CRA may consider~~ed~~ or analyze~~d~~ to determine a credit rating. ~~and the analytical process to be undertaken to determine the credit rating, including, as applicable, the models, financial metrics, assumptions, criteria, or other quantitative or qualitative factors to be used to determine the credit rating.~~

1.4 Definition of "employee"

The definitions of "*employee"* and "contractor" should not be so broad as to cover all employees and contractors, and should only refer to those who are involved in the credit rating process. We suggest a small change to the definition to make the above clear.

> *"Employee" means any individual or contractor subject to the CRA's policies, procedures and controls, who works for the CRA on a full-time, part-time, or temporary basis and who is involved in the credit rating process ~~including any individual working as a contractor who is involved in the credit rating process~~.*

1.5 Definition of "trading instrument"

MIS believes that the definition of trading instrument should be limited to those instruments that are clearly identifiable and relevant to the conflicts of interest provisions (as per the comment in paragraph 3.2); particularly as it has been proposed that the CRAs should "*enforce"* these measures.

> *"Trading instrument" means a security, money market instrument, derivative, or other similar product excluding holdings in diversified investment schemes and those trading instruments that form part of non-discretionary funds.*

1.6 Definition of "credit rating process"

The definition of "credit rating process" should only include those processes which relate to the determination of the rating. The "selection and assignment of analysts to work on the matter" is arguably not part of the credit rating process and the "decision making activities" is too broad a term for inclusion in the definition.

> *"Credit rating process" means all the steps taken with respect to a credit rating action including, but not limited to, the CRA's ~~selection and assignment of analysts to work on the matter~~, application of the credit rating methodology, the determination of the credit rating ~~decision-making activities (e.g., the operation of a rating committee~~), interaction with the rated entity, obligor, originator, underwriter, or arranger, and dissemination of the credit rating publicly or to subscribers.*

1.7 Introduction to the IOSCO Code

Asymmetry of Information

In financial market transactions, the issuer of the security is in possession of all of the relevant information that would be of use to investors. Therefore, to the extent that the IOSCO Code seeks to eliminate this asymmetry between issuers and investors, the IOSCO Code should not refer to "users of credit ratings" as that term is not synonymous with the term "investors."

> *As described in the IOSCO CRA Principles, CRAs should endeavor to issue credit ratings that help reduce the asymmetry of information that exists between rated entities~~, obligors, originators, underwriters, and arrangers~~, on one side, and ~~users of credit ratings~~ investors on the other.*

Extension of the CRA's obligations under the IOSCO Code to transaction counterparties

As mentioned in the cover letter, proposed changes to the IOSCO Code may lead to the perception that credit ratings are opinions on the credit risk of entities other than the rated entity such as the obligor, underwriter and arranger. An example of what we consider to be an inappropriate reference to the broader set of counterparties is set out below, and we have suggested changes to the draft in line with our comments:

> *Stale ratings that fail to reflect changes to the financial condition or prospects of a rated entity, ~~obligor, originator, underwriter, or arranger~~ may mislead market participants. Likewise, conflicts of*

interest or other undue factors – internal and external – that might, or even appear to, impinge upon the independence of a credit rating action can seriously undermine a CRA's credibility. Where conflicts of interest or a lack of independence is common at a CRA and hidden from investors, overall investor confidence in the transparency and integrity of a market can be harmed. ~~CRAs also have responsibilities to the investing public and to rated entities, obligors, originators, underwriters, and arrangers, including a responsibility to protect the confidentiality of some types of information these entities share with them.~~

2. QUALITY AND INTEGRITY OF THE CREDIT RATING PROCESS

A. Quality of the Credit Rating Process

2.1 Section 1.1 – enforcement of methodology

For the reasons set out in the cover letter, MIS is concerned about the proposed definition of "*credit rating methodology*". This concern carries through to the proposed requirement in section 1.1 which seeks to introduce an enforcement requirement for rating methodologies. As new products are developed and new CRAs participate in the market, not all ratings will have historical experience as part of the content of the methodology. In this regard, we suggest deleting the reference to enforcement and focus instead on the use of the methodology, while retaining the qualification of "where possible" with respect to historical experience that currently exists within the IOSCO Code.

1.1 a CRA should establish, maintain, document <u>and apply</u> ~~and enforce~~ a credit rating methodology for each class of entity or obligation for which the CRA issues credit ratings. Each credit rating methodology should be rigorous, capable of being applied consistently, and <u>where possible,</u> result in credit ratings that can be subjected to some form of objective validation based on historical experience.

2.2 Section 1.2 – credit rating reports

As CRAs disseminate and publish reports that are not necessarily related to the credit rating process, the reference within section 1.2 to "analytical report" is too broad and should more accurately refer to credit rating reports. "Credit rating report" or "report" used after the reference to credit rating is also the terminology used throughout the IOSCO Code (see for example sections 1.9, 1.16, 2.7, 2.8 and 3.5).

1.2 Credit ratings should reflect all information known, and believed to be relevant, to the CRA, consistent with the applicable credit rating methodology that is in effect. Therefore, the CRA should establish, maintain, document, and enforce policies, procedures, and controls to ensure that the credit ratings and ~~analytical reports~~ <u>credit rating reports</u> it disseminates are based on a thorough analysis of all such information.

2.3 Section 1.8 – record retention

In the absence of IOSCO introducing a record retention requirement that could be applied globally, we believe that the record retention period should be governed by local law and the CRA's view on the integrity of the credit rating process.

1.8 A CRA should maintain internal records that are accurate and sufficiently detailed and comprehensive to reconstruct the credit rating process for a given credit rating action. The records should be retained <u>for the period required by local law</u> or regulation and where the CRA considers such retention to be necessary to promote the integrity of the CRA's credit rating process,

including to permit internal audit, compliance, and quality control functions to review past credit rating actions in order to carry out the responsibilities of those functions. Further, a CRA should establish, maintain, document, and enforce policies, procedures, and controls designed to ensure that its employees comply with the CRA's internal record maintenance, retention, and disposition requirements and with applicable laws and regulations governing the maintenance, retention, and disposition of CRA records.

2.4 Section 1.10 – sufficient resources to make an opinion

Consistent with our comments above, we believe that the credit rating process should not be perceived as a purely mechanical or quantitative determination. The ability of the CRA to formulate a high quality opinion should be the determining factor in assessing the resources provided to analysts.

1.10 A CRA should ensure that it has and devotes sufficient resources to carry out high-quality credit ~~assessments~~ ratings of the entities and obligations for which it issues and maintains credit ratings.

When deciding whether to issue a credit rating for an entity or obligation, a CRA should assess whether it is able to devote a sufficient number of analysts with the skill sets to make a high quality credit ~~assessment~~ rating, and whether the analysts will have access to sufficient information needed in order to make the ~~assessment~~ opinion.

2.5 Section 1.14 – ongoing monitoring of credit rating

As some credit ratings are point-in-time and do not entail ongoing surveillance (as per the first paragraph below), this concept should be retained throughout this section (including the second paragraph which can be combined into this section).

1.14 A CRA should ensure that sufficient employees and financial resources are allocated to monitoring and updating its credit ratings. Except for credit ratings that clearly indicate they do not entail ongoing surveillance, once a credit rating is published, the CRA should monitor the credit rating on an ongoing basis by:

a. reviewing the creditworthiness of the rated entity or obligation regularly;

b. initiating a review of the status of the credit rating upon becoming aware of any information that might reasonably be expected to result in a credit rating action (including withdrawal of a credit rating), consistent with the applicable credit rating methodology;

c. reviewing the impact of the change in the credit rating methodologies, models or key rating assumptions on the affected credit ratings within a reasonable period of time; ~~and~~

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

e .incorporating all cumulative experience obtained; and

f. applying changes in credit rating methodologies to both initial credit ratings and subsequent credit rating actions.

~~Monitoring of existing credit ratings should incorporate all cumulative experience obtained. Changes in credit rating methodologies should be applied to both initial credit ratings and subsequent credit rating actions.~~

2.6 Section 1.19 – standard of ethical behavior

MIS agrees that CRA employees should be held to a high standard of ethical behavior in line with the IOSCO Code. As there is no objective standard of ethics, this should be determined by the CRAs and implemented through their own Codes of Conduct subject to local law.

> *1.19 A CRA's employees should be held to the highest standards of integrity and ethical behavior, and the CRA should have policies and procedures in place that are reasonably designed to ensure that ~~employ~~ individuals with demonstrably compromised integrity are not employed.*

3. CRA INDEPENDENCE AND AVOIDANCE OF CONFLICTS OF INTEREST

B. CRA Policies, Procedures, Controls and Disclosures

3.1 Section 2.9 – requirement to encourage third party disclosure

As CRAs are independent entities and are not advisors to the issuer or on the transaction, it is inconsistent with the role of CRAs to: (i) encourage issuers to disclose information; and/or (ii) disclose with their credit rating what the issuer told the CRA about what it intended to disclose to the market. Having CRAs make such disclosures may contribute to the perception that CRAs are gatekeepers, which can lead to over-reliance on CRAs. Instead of imposing obligations on CRAs, we believe that regulators should enhance the mandatory disclosure and enforcement regime with respect to issuers' disclosures if they believe that the existing framework is inadequate.

> ~~*2.9 A CRA should publicly disclose in its credit rating announcement whether the issuer of a structured finance product has informed the CRA that it is publicly disclosing all relevant information about the obligation being rated or if the information remains non-public. If the information remains non-public, the CRA should encourage the issuer to publicly disclose the information.*~~

3.2 Section 2.14 – protections against conflicts of interest

The proposed revisions expand the scope of persons who should not engage in the identified activities that create conflicts to include a "close relative" of the CRA employee and "an entity managed by the CRA employee". The explanation of who is a "close relative" should be moved to be a term of the IOSCO Code.

The proposed revisions identify (in provision 2.14) an extended conflict of interest: holding or transacting in a trading instrument issued by an arranger or underwriter of the obligation. The definition of "trading instrument" is very broad and potentially includes any investment product. This poses compliance concerns as a CRA with a robust conflicts of interest policy would find it difficult to ensure that no employee (which may also be interpreted widely using the proposed definition) had any trading instruments issued by these parties. The qualification of *other than a diversified collective investment scheme* contained in section 2.14 (b), or similar wording, should be included in the definition of "*trading instrument*" (see above comment on definition of "*trading instrument*") as the inclusion of diversified collective investment schemes and other non-discretionary financial instruments will put a large compliance burden on the CRA to determine the underlying securities where the employee himself is not aware of the makeup of his portfolio.

As the conflict of interest provisions have been extended to obligors, arrangers and underwriters, and as these entities may not be known to the employees as being part of the rating process (for example in structured finance deals), these provisions should be qualified so that the employee is only covered by this provision when he is reasonably aware of the potential for conflict of interest.

2.14 A CRA employee should not participate in or otherwise influence a CRA's credit rating action with respect to an entity or obligation if the employee is aware, or ought reasonably to be aware, that a close relative of the employee (e.g., spouse, domestic partner, or dependent), or an entity managed by the employee (e.g., a trust).....

3.3 Section 2.17 – knowledge of employees

As with provision 2.14 above, the employee should be aware of the obligor, underwriter or arranger to any obligation before he or she is required to disclose any relationship with a person from those entities. In addition, the disclosure should only be to the rated entity that the employee is rating as extending it to all rated entities would impose an impossible burden on the employee and compliance function within the CRA.

2.17 A CRA employee who becomes involved in a personal relationship that creates an actual or potential conflict of interest (including, for example, a personal relationship with an employee of a rated entity, and obligor, or the underwriter or arranger of a rated obligation where the CRA employee is involved in the process of rating that entity, should be required under the CRA's policies, procedures, and controls to disclose the relationship to the compliance officer or another officer of the CRA, as appropriate.

4. CRA RESPONSIBILITIES TO THE INVESTING PUBLIC, RATED ENTITIES, OBLIGORS, ORIGINATORS, AND ARRANGERS

A. Transparency and Timeliness of Credit Ratings Disclosure

4.1 Section 3.1 – use of plain language

The "*plain language*" requirement in section 3.1 of the IOSCO Code is unnecessary and could lead to confusion among market participants about how credit ratings should and should not be used. Financial market professionals have the resources and power to request that CRAs communicate their opinions in a way that they find useful. If a CRA does not communicate its opinions in a way that market professionals find helpful, the credit ratings will not be used and issuers will not request ratings from the CRA. This would also jeopardise one of the key attributes of credit ratings and could potentially lead to market participants discounting the credibility of credit ratings. Plain language requirements in financial services regulation typically are associated with products and services intended for use by retail customers. Credit ratings, however, are designed for use by market professionals. Moreover, because there is no objective standard for "plain language", this provision could result in CRAs being encouraged or required to over-simplify a necessarily complex analysis, which would not benefit the market as a whole. The requirement also would make it difficult for national supervisors to conduct a review of compliance with this provision without evaluating and commenting on the meaning of words used in such publications.

3.1 A CRA should assist investors and other users of credit ratings in developing a greater understanding of credit ratings by publicly disclosing in plain language, among other things, the nature and limitations of credit ratings and the risks of unduly relying on them to make investment or other financial decisions. A CRA that is subject to a CRA registration and oversight program administered by a regional or national authority should not state or imply that the authority endorses its credit ratings or use its registration status to advertise the quality of its credit ratings.

4.2 Section 3.6 – definition of default

Not all CRAs rate to default. Some, including MIS, rate to expected loss. For this reason, specific mention of the definition of default should not be made in section 3.6.

> *3.6 A CRA should publicly disclose clear definitions of the meaning of each category in its rating scales, including the definition of default.*

4.3 Section 3.9 – opportunity to comment on the credit rating

The proposed revisions in section 3.9 allowing for corrections that "*would have a material effect on the credit rating*" instead of corrections that "the CRA would wish to be made aware of in order to produce an accurate rating" should not be allowed to be used by the issuer who considers that certain information should be given greater weight than others so as to interfere with the methodology of the CRA. CRAs ability to consider and determine what is relevant to the credit rating action must remain in order for CRA's opinions to be regarded as independent. In addition, as mentioned in our letter and our comment on the introduction to the IOSCO Code, the extension of the ability to comment to third parties such as obligor, underwriter and arranger is inappropriate. The CRA should only be expected to interact with the rated entity or its nominated agent.

> *3.9 Where feasible and appropriate, a CRA should inform the rated entity , or the obligor, underwriter, or arranger of the rated obligation about the critical information and principal considerations upon which a credit rating will be based prior to taking a credit rating action and afford the rated entity , obligor, underwriter, or arranger an adequate opportunity to clarify any factual errors, omissions, or other misperceptions that would have a material effect on the credit rating. The CRA should duly evaluate any response from the rated entity, obligor, underwriter, or arranger where it considers the response to be relevant to the credit rating action. Where in particular circumstances the CRA has not informed the rated entity , obligor, or arranger prior to taking a credit rating action, the CRA should inform the rated entity , obligor, or arranger as soon as practical thereafter and, generally, should explain why the CRA did not inform the rated entity , obligor, or arranger prior to taking the credit rating action.*

4.4 Section 3.15 – use of term "easily understand"

The proposed revisions to section 3.15 intended to enhance the transparency standard so that people can "*easily understand*" the disclosures (rather than "understand" the disclosures) may inadvertently give the erroneous impression that credit ratings are intended for a non- market professionals. Please see our comment on section 3.1 above.

> *3.15 When rating a structured finance product, a CRA should publicly disclose or distribute to its subscribers (depending on the CRA's business model) sufficient information about its loss and cash-flow analysis with the credit rating, so that financial market professionals investors, other users of credit ratings, and/or subscribers can easily understand the basis for the CRA's credit rating. The CRA should also publicly disclose or distribute information about the degree to which it analyzes how sensitive a credit rating of a structured finance product is to changes in the assumptions underlying the applicable credit rating methodology.*

4.5 Section 3.17 – withdrawal of ratings

As a rating is most often withdrawn or no longer monitored when the debt is paid off or the instrument has matured or expired, these events should be specifically excluded. The requirement to disclose the reasons for withdrawal or the fact that a rating is no longer monitored should only extend to an obligation that remains in existence.

3.17 If a CRA discontinues monitoring a credit rating for a rated entity or obligation other than where the debt has matured or the instrument has expired, it should either withdraw the credit rating or disclose such discontinuation to the public or to its subscribers (depending on the CRA's business model) as soon as practicable. A publication by the CRA of a credit rating that is no longer being monitored, other than where the debt has matured or the instrument has expired, should indicate the date the credit rating was last updated or reviewed, the reason the credit rating is no longer monitored, and the fact that the credit rating is no longer being updated.

4.6 Section 3.18 – time period for historical information

In the absence of IOSCO prescribing a specific period of time, it would be more appropriate for the CRA to determine the appropriate period of time for disclosure of historical information taking into account the objective of section 3.18 to assist investors and other financial market professionals in comparing different CRAs' ratings. In addition, as per our earlier comment on credit rating methodology, it may not be possible for all CRAs to publish rating performance statistics covering the same periods for all products. Requiring such disclosure in every such occurrence would be burdensome (particularly for new CRAs) and would provide no further insight into the performance of different CRAs.

3.18 To promote transparency and to enable ~~investors and other users of credit ratings~~ financial market professionals to compare the performance of different CRAs, a CRA should disclose sufficient information about the historical transition and default rates of its credit rating categories with respect to the classes of entities and obligations it rates. This information should include, where possible, verifiable, quantifiable historical information, organized and structured ~~over a range of years~~ over a period of time as determined by a CRA, and, where possible, standardized in such a way to assist ~~investors and other users of credit ratings~~ financial market professionals in comparing different CRAs. Where historical transition and default rates exist for a particular rated entity or obligation but the nature of the rated entity or obligation or other circumstances make ~~as~~ such a historical transition or default rate inappropriate, statistically invalid, or otherwise likely to mislead investors or other users of credit ratings, the CRA should disclose why this is the case.

B. The Treatment of Confidential Information

4.7 Section 3.19 – using or disclosing confidential information to employees

Notwithstanding the fact that CRA analysts are separate from other functions within the organisation and that protection of confidential information is a core principle, on occasion there may be a need to provide confidential information to employees other than those involved in the credit rating process, such as members of a CRA's Legal Department. In this instance, the duty of confidentiality remains but the CRA should not be restricted from providing the information.

3.19 A CRA should establish, maintain, document, and enforce policies, procedures, and controls to protect confidential and/or material non-public information, including confidential information received from a rated entity, ~~or the obligor, underwriter, or arranger of a rated obligation~~, and non-public information about a credit rating action (e.g., information about a credit rating action before the action is publicly disclosed or disseminated to subscribers).

a. The policies, procedures, and controls should prohibit the CRA and its employees from using or disclosing confidential and/or material non-public information for any purpose unrelated to the CRA's credit rating activities, ~~including disclosing such information to other employees where the~~

disclosure is not necessary in connection with the CRA's credit rating activities, unless disclosure is required by applicable law or regulation.

4.8 Section 3.21 – objective of the policies and procedures

To be consistent with terminology in the IOSCO Code, the use of the term "*designed*" should be included wherever the CRA is required to establish, maintain, document and enforce policies, procedures and controls. Even if the CRA puts in place policies and procedures designed to address the objectives of the IOSCO provision and takes steps to enforce those procedures, it cannot guarantee compliance in all circumstances.

3.21 A CRA should establish, maintain, document, and enforce policies, procedures, and controls that designed to prohibit employees that possess confidential and/or material non-public information concerning a trading instrument from engaging in a transaction in the trading instrument or using the information to advise or otherwise advantage another person in transacting in the trading instrument.

5. GOVERNANCE, RISK MANAGEMENT, AND EMPLOYEE TRAINING

5.1 Section 4.1 – board and management responsibility

MIS supports IOSCO's objective of strengthening the IOSCO Code regarding governance, training and risk management. Consistent with the principles of corporate governance, MIS believes, however, that a distinction should be made between the CRA's board of directors and its executive management in regard to the ultimate responsibility for enforcement of that CRA's Code. The board of directors of an entity is responsible for the strategy of the organisation whereas the executive retains primary responsibility for the execution of that strategy in accordance with relevant law. In addition, the IOSCO Code adopts a comply-or-explain approach (the introduction to the IOSCO Code states that "CRAs should explain if and how their codes of conduct deviate from the IOSCO Code"). This indicates that the measures set forth in the IOSCO Code are not intended to be all-inclusive and therefore an individual CRA's Code should offer a degree of flexibility subject to each CRA's specific legal, business, and market circumstances. In this regard, MIS recommends against too rigid an interpretation of the requirement that management, as directed by the board of a CRA, have ultimate responsibility for ensuring that the CRA establishes, maintains, documents and **enforces** a code that gives **full** effect to the IOSCO Code. As IOSCO has indicated, the measures set forth in the IOSCO Code are not intended to be all-inclusive and therefore the enforcement of a code that gives full effect to the IOSCO Code may not be possible taking into account differing requirements in local laws. As the IOSCO Code itself is not designed to be rigid or formulistic, the board of a CRA should allow the management to have a degree of flexibility in how these measures are incorporated into the individual codes of conduct according to each CRA's specific legal, business, and market circumstances.

4.1 A CRA's board (or similar body) should have ultimate responsibility for ensuring that the management of the CRA establishes, maintains, documents, and enforces a code of conduct that gives full effect to the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies.