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16 April 2010

Response to the Basel Committee on Banking Supervision Consultative Document relating to *Strengthening the resilience of the banking sector*

The International Organization of Securities Commission (IOSCO) is grateful for the opportunity to provide comments to the Basel Committee on Banking Supervision (Basel Committee) on its consultative report, issued in December 2009, entitled *Strengthening the Resilience of the Banking Sector* (Consultative Report).[1]

As the leading international grouping of securities regulators, IOSCO aims to establish high standards for regulation. In recent years, it has established a set of guiding principles for credit rating agencies (CRAs) and developed a model code of conduct for CRAs (IOSCO Code of Conduct). We have, therefore, a keen interest in the application of IOSCO principles for CRAs. In that regard, we wish to comment on language proposed in the Consultative Report that would, we believe, unintentionally conflict with the IOSCO's objective that its Code of Conduct for CRAs be based on a "comply or explain" approach so that it could be applicable to all types of CRAs engaged in a variety of different business models.

Paragraph 196 of the consultative document proposes to incorporate elements of the IOSCO Code of Conduct for CRAs into the Basel II framework by revising paragraphs 90, 91 and 565(b) of that framework. The proposed revision to paragraph 565(b) would require that in order for the ratings issued by a CRA that qualifies as an External Credit Assessment Institution (ECAI) to be used within the securitisation framework, the CRA/ECAI must provide a credit assessment (*i.e.*, external rating) "free of charge." The proposed revision is understandable, considering a prudential supervisor's concern that credit ratings issued by subscription-based CRAs are only available to defined people. Furthermore, this revision is in line with 3.4 of the IOSCO Code of Conduct.

[1] Available at http://www.bis.org/publ/bcbs164.pdf?noframes=1

The proposed language in the Consultative Report, however, could establish a barrier to the use of ratings issued by subscription-based CRAs within the securitisation framework, even if the CRA issuing the ratings qualifies as an ECAI. In contrast, we support an approach that would permit ratings of a subscription-based CRA to be used within the securitisation framework, if such a CRA explains why, in light of its business model, it cannot make credit ratings available free of charge.

Unlike CRAs that operate under an issuer-paid model, subscription-based CRAs are not paid by issuers to provide credit assessments. Instead, they generate revenue by charging subscribers for access to their ratings. As such, issuing ratings "free of charge" is incompatible with the subscriber-paid CRA model. Thus, under the proposed wording, although a subscription-based CRA could qualify as an ECAI under the criteria set forth in paragraph 91 of the Basel II Framework, its ratings would be considered "ineligible" for purposes of providing credit assessments within the securitised framework since they are not available "free of charge" despite the fact that they would remain eligible for any other purpose within the Basel II framework.

In connection with proposing this language, the Consultative Report asks whether it would be appropriate to allow an ECAI that does not provide credit assessments free of charge to provide "an adequate justification, within their own publicly available Code of Conduct, in accordance with the 'comply or explain' nature of the IOSCO code" (see paragraph 197 of the consultative report).[2] We believe that this proposal is an acceptable solution, provided that the Basel Committee would deem it to be an "adequate justification" if a CRA that qualified as an ECAI were to explain that its business model is subscription-based. In other words, if a CRA qualifies as an ECAI, it is our view that the Basel Committee should not prevent its ratings from being eligible for use within the securitisation framework solely because it operates under the subscription-based model and, therefore, by necessity, cannot make its credit assessments available "free of charge." We believe that this is the intent of paragraph 197 of the consultative report, and we support it.

If, however, a subscription-based CRA business model would not be considered by the Basel Committee to be "adequate justification" as described above, the current proposal would then most likely have the unintended impact of negatively diminishing the viability of the subscription-based CRA business model. This could lead to a decrease in the number of CRAs and hence a decrease in the number of ratings available for investors to consider. We believe CRAs operating under the subscription-based model can operate as a check on CRAs operating under the issuer-paid business model and vice versa insomuch as each model is subject to different types of potential conflicts (e.g.,

[2] Paragraph 197 of the Consultative Report states as follows: "For the proposed changes to paragraph 565(b), the Committee is soliciting public comment regarding potential flexibility for the requirements that eligible credit assessments be publicly available. Such flexibility could be incorporated into the framework by including a footnote as follows: Footnote: *Where the eligible credit assessment is not provided free of charge the ECAI should provide an adequate justification, within their own publicly available Code of Conduct, in accordance with the 'comply or explain' nature of the IOSCO code."*

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being paid by investors as opposed to being paid by issuers). Consequently, promoting both business models potentially can improve ratings quality.

Regards,

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