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International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
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Paris, 28 May 2008

IOSCO to implement changes to Code of Conduct for Credit Rating Agencies

The International Organization of Securities Commissions (IOSCO) has today published the final report containing amendments to the *Code of Conduct Fundamentals for Credit Rating Agencies* (Code of Conduct).

The changes to the Code of Conduct have been introduced following a public consultation process involving regulators, credit rating agencies (CRAs) and financial market stakeholders. These changes are intended to address issues which have arisen in relation to the activities of CRAs in the market for structured finance products. Structured finance products backed by U.S. subprime retail mortgages have figured prominently in the recent global market turmoil, and the quality of the credit ratings of these products – and the CRA policies and methodologies that resulted in these ratings – have been questioned by many securities regulators and market observers.

Michel Prada, Chairman of IOSCO's Technical Committee, said:

“IOSCO's Code of Conduct aims to improve investor protection, improve the fairness, efficiency and transparency of securities markets and to reduce systemic risk. We have engaged in a frank and constructive dialogue with the CRA industry, issuers and investors and have taken a broad range of views into account in finalizing the changes to our code.

“I believe that these changes to the Code of Conduct will help to address a number of issues that have arisen as a result of the current credit crisis regarding how the credit ratings for structured finance products are developed by credit ratings agencies and relied upon by issuers and investors.

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“IOSCO’s members expect credit rating agencies to give full effect to the Code of Conduct and to demonstrate to regulators and market participants, how they implement the Code of Conduct through their own codes of conduct. IOSCO will continue to monitor, as will IOSCO’s individual members, how the industry implements the Code of Conduct.”

The amended Code of Conduct will assist CRAs in strengthening their processes and procedures to protect the integrity of the ratings process, ensure that investors and issuers are treated fairly and safeguard confidential material information provided.

The following amendments have been made to the Code of Conduct:

Quality and Integrity of the Rating Process – Code of Conduct Section 1

This section will be modified such that CRAs should:

- prohibit CRA analysts from making proposals or recommendations regarding the design of structured finance products that the CRA rates;
- adopt reasonable measures so that the information they use is of sufficient quality to support a credible rating. If the rating involves a type of financial product with limited historical data upon which to base a rating, the CRA should make clear, in a prominent place, the limitations of the rating;
- establish and implement a rigorous and formal review function responsible for periodically reviewing the methodologies and models and significant changes to the methodologies and models it uses;

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- take steps that are designed to ensure that the decision-making process for reviewing and potentially downgrading a current rating of a structured finance product is conducted in an objective manner;
- ensure that CRA employees that make up CRA rating committees have appropriate knowledge and experience in developing a rating opinion for the relevant type of credit;
- establish new products review functions to review the feasibility of providing a credit rating for a type of structure that is materially different from the structures a CRA currently rates.
- assess whether existing methodologies and models for determining credit ratings of structured products are appropriate when the risk characteristics of the assets underlying a structured product change materially;
- ensure that adequate resources are allocated to monitoring and updating its ratings.

CRA Independence and Avoidance of Conflicts of Interest - Code of Conduct section 2

This section will be modified such that CRAs should:

- to discourage “ratings shopping,” disclose in their rating announcements whether the issuer of a structured finance product has informed it that it is publicly disclosing all relevant information about the product being rated;
- disclose whether any one issuer, originator, arranger, subscriber or other client and its affiliates make up more than 10 percent of the CRA’s annual revenue;
- establish policies and procedures for reviewing the past work of analysts that leave the employ of the CRA;

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- conduct formal and periodic reviews of remuneration policies and practices for CRA analysts to ensure that these policies and practices do not compromise the objectivity of the CRA's rating process;
- define what it considers and does not consider to be an ancillary business and why.

CRA Responsibilities to the Investing Public and Issuers - Code of Conduct section 3

This section will be modified such that CRAs should:

- publish verifiable, quantifiable historical information about the performance of its rating opinions, organized and structured, and, where possible, standardized in such a way to assist investors in drawing performance comparisons between different CRAs;
- differentiate ratings of structured finance products from other ratings, preferably through different rating symbols;
- indicate the attributes and limitations of each credit opinion, and the limits to which it verifies information provided to it by the issuer or originator of a rated security;
- provide investors and/or subscribers (depending on the CRA's business model) with sufficient information about its loss and cash-flow analysis of structured finance products so that an investor allowed to invest in the product can understand the basis for the CRA's rating. CRAs should also disclose the degree to which they analyze how sensitive a rating of a structured financial product is to changes in the CRA's underlying rating assumptions;
- disclose the principal methodology or methodology version in use in determining a rating.

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Disclosure of the Code of Conduct and Communications with Market Participants – Code of Conduct section 4

- A CRA should publish in a prominent position on its home webpage links to the CRA’s code of conduct; a description of the methodologies it uses; and information about the CRA’s historic performance data.

NOTES FOR EDITORS

1. [The Role of Credit Rating Agencies in Structured Finance Markets – Final Report](#) is available on the IOSCO website.
2. The new version of the [Code of Conduct Fundamentals for Credit Rating Agencies](#) is available on the IOSCO website.
3. The [Comments Received in Relation to the Consultation Report, The Role of Credit Rating Agencies in Structured Finance Markets, Report of the Technical Committee of IOSCO](#) received from financial market stakeholders are also published today on IOSCO’s website.
4. The final Report on the Role of Credit Rating Agencies in the Structured Finance Market reflects changes based on comments IOSCO received from financial market stakeholders
5. [IOSCO Briefing Note 1](#) outlines the changes to the Code of Conduct
6. IOSCO published its [Review of Implementation of the IOSCO Fundamentals of a Code of Conduct for Credit Rating Agencies, Report of the Technical Committee of IOSCO](#) in February 2007. [Responses](#) to the consultation were published on IOSCO’s website in May 2007.
7. The [Technical Committee](#), a specialised working group established by IOSCO’s Executive Committee, is made up of fifteen agencies that regulate some of the worlds larger, more developed and internationalized markets. Its objective is to review major regulatory issues related to international securities and futures transactions and to coordinate practical responses to these concerns. Mr. Michel Prada, Chairman of the Autorit  des March s Financiers (AMF) of France, currently acts as Chairman of the Technical Committee. The members of the IOSCO Technical Committee are: the Australian Securities and Investments Commission; Autorit  des March s Financiers, France; Bundesanstalt f r Finanzdienstleistungsaufsicht (BaFin), Germany; Commissione Nazionale per la Societ  e la Borsa, Italy; Securities and Futures Commission, Hong Kong; Financial Services Agency, Japan; Comisi n Nacional Bancaria y de Valores, Mexico;

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Autoriteit Financiële Markten, the Netherlands; Securities Commission, Ontario; Autorité des Marchés Financiers, Quebec; Comisión Nacional del Mercado de Valores, Spain; Commission Fédérale des Banques, Switzerland; Financial Services Authority, United Kingdom; Securities and Exchange Commission, United States and; Commodity Futures Trading Commission, United States.

8. The Technical Committee can also create, on an ad hoc basis, task forces to examine specific areas of concern. There are currently separate task forces working on the areas of corporate governance, credit rating agencies, private equity and audit services.
9. IOSCO is recognized as the leading international policy forum for securities regulators. The organization's wide membership regulates more than 90% of the world's securities markets and IOSCO is the world's most important international cooperative forum for securities regulatory agencies. IOSCO members regulate more than one hundred jurisdictions and the Organization's membership is steadily growing.
10. IOSCO aims through its permanent structures:
 - to cooperate together to promote high standards of regulation in order to maintain just, efficient and sound markets;
 - to exchange information on their respective experiences in order to promote the development of domestic markets;
 - to unite their efforts to establish standards and an effective surveillance of international securities transactions;
 - to provide mutual assistance to promote the integrity of the markets by a rigorous application of the standards and by effective enforcement against offenses.

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