Insight beyond the rating.

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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland
E-mail: baselcommittee@bis.org

Dear Secretariat of the Basel Committee on Banking Supervision
("Basel Committee"):

Re: DBRS' response to the Basel Committee public consultation on strengthening the resilience of the banking sector ("bank sector proposals" or "consultation paper")

DBRS appreciates the opportunity to provide its comments on the banking sector proposals. DBRS is a global credit rating agency with international regulatory recognition and market acceptance including as an eligible External Credit Assessment Institution ("ECAI").[1]

DBRS has primarily focused its comments regarding the banking sector proposals on those areas that impact the use of credit ratings. DBRS agrees with the consultation paper that excessive or sole use of credit ratings by market participants is inappropriate. Rather, credit ratings should be used a supplementary risk and comparative tool to assist investors and other market participants in their investment decision making. The banking sector proposals recognize that using credit ratings for capital purposes provide a "relatively standardized, harmonized, easy to understand, independent (third party) measure that generally reflects the credit quality of a counterparty, issuer or investment product." The consultation paper also states "that the removal of external ratings from the Basel II framework could raise additional issues for determining regulatory capital requirements." DBRS appreciates the balanced conclusions of the Basel Committee.

The consultation paper proposes the following additional measures to address the excessive reliance on external ratings[2]: 1) require banks to perform their own internal assessments of externally rated securitisation exposures; 2) eliminate certain "cliff effects" associated with credit risk mitigation practices; and 3) incorporate key elements of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies ("IOSCO Code") into the Basel II eligibility

[1] Please refer to Regulatory Affairs on **www.dbrs.com** for a list of DBRS registrations, recognitions and approvals in Canada, the U.S., Europe and other jurisdictions. As an existing ECAI, DBRS will be registering under the new European Union Regulation on Credit Rating Agencies ("EU CRA Regulation") by September 2010.

[2] Under Basel II, external ratings are primarily applied in the Standardized Approach ("SA") and securitization ("SF") framework.

requirements for ECAIs. We also understand that Basel is conducting a more fundamental review of the securitization framework and the reliance on external ratings ("securitization review").

DBRS generally supports these banking sector proposals and believes they will add greater clarity in the use of ratings. DBRS also appreciates the proposals for potential flexibility regarding the use of private ratings and unsolicited ratings. However, DBRS would encourage regulators to permit inclusion of these ratings where an ECAI's ratings process is no different to that for its public ratings.

Over the last two years, DBRS has spent considerable efforts to strengthen its internal governance to manage the potential for conflicts of interest and to increase the transparency and disclosure of its rating policies, processes and methodologies to ensure consistently high ratings quality.[3] Among other things, DBRS maintains a publicly available Business Code of Conduct that reflects the IOSCO Code, U.S. Securities and Exchange Commission (SEC) rules[4] and DBRS best practices. DBRS accordingly adjusts its policies, processes and methodologies to meet new requirements such as the EU CRA Regulation, and to ensure it maintains high standards of independence, integrity and transparency.

Incentive to avoid getting exposures rated

Under SA, sovereign, corporate and bank exposures rated below BB- or B- typically have a higher risk-weight than unrated borrowers. The consultation paper cites that banks might, therefore, prefer companies that are likely to be rated lower than BB- to avoid getting a rating so they can hold less capital against such exposures.

DBRS would agree that it is prudent to remove the disincentive for banks to be exposed to unrated companies that are likely to be rated lower than BB-. In this regard, DBRS believes it is a positive development to encourage banks to undertake their own assessments regardless of whether an exposure is rated or unrated.

Incorporation of language into the Basel II framework to incorporate the IOSCO Code

The consultation proposes that: 1) the IOSCO Code be codified as part of the ECAI eligibility criteria for ECAIs; 2) national supervisors determine on a continuous basis whether an ECAI meets the ECAI eligibility criteria; and 3) an ECAI continues to satisfy the existing requirements for objectivity, independence, resources and credibility with some changes suggested for international access/transparency ("transparency") and disclosure as noted below.

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[3] Refer to the November 30, 2009 commentary – "How DBRS Maintains Independence and Ratings Quality" found under Regulatory Affairs on **www.dbrs.com**.

[4] Rules for registered Nationally Recognized Statistical Rating Organizations (NRSROs) pursuant to the Credit Rating Agency Reform Act of 2006.

For transparency, the consultation paper proposes that for individual assessments, the key elements underlining the assessments and whether the issuer participated in the assessment process should be publicly available on a non-selective basis, unless they are private assessments provided only to the issuer. In addition, the general procedures, methodologies and assumptions for arriving at assessments used by the ECAI should be publicly available.

For disclosure, it is proposed that an ECAI should disclose: its code of conduct; its compensation arrangements with assessed entities; its assessment methodologies, including the definition of default, the time horizon, and the meaning of each rating; the actual default rates experienced in each assessment category; and the transitions of the assessments, e.g. the likelihood of AA ratings becoming A over time.

As previously outlined, DBRS has adopted the IOSCO Code and believes its incorporation into the ECAI requirements provides for a set of consistent base standards and additional rigor. DBRS has set a high bar regarding transparency and disclosure. Other than private ratings and ratings on certain private placement transactions, DBRS ratings and the key elements underlining its ratings, policies, methodologies and assumptions are publicly available, on a non-selective basis and free of charge on its website, **www.dbrs.com**.

Other than in respect of unsolicited ratings, issuers participate in DBRS' ratings process. As per DBRS' policy on unsolicited ratings, an issuer's non-participation in the ratings process is noted in each related press release. DBRS maintains an array of policies and procedures to address and manage conflicts of interest to ensure independence from all entities it rates[5]. DBRS believes its approach regarding unsolicited ratings is very transparent and as such, suggests it is not necessary to state in every individual assessment whether the issuer participated.

DBRS agrees that ongoing regulatory monitoring would provide an additional layer of prudent oversight to help ensure the ECAI standards are followed. Ongoing regulatory monitoring would also provide additional confidence to the users of ECAI ratings.

Fundamentally, DBRS agrees with the six ECAI criteria and the suggested revisions to transparency and disclosure except for public disclosure of its compensation arrangements. Such disclosure would be in contravention of the SEC conflicts of interest fee rule that prohibits and separates analytical staff from being involved in any aspect of the compensation/fee process. Consistent with the IOSCO Code, DBRS believes that best practice in this area should separate involvement in fee arrangements from analytical work. The publication of fee arrangements would make such separation impossible.

Operational requirements for use of external credit assessments

The consultation paper proposes that the procedures, methodologies, assumptions, and the key elements underlining the credit assessments must be publicly available, on a non-selective basis

[5] A summary of DBRS Policies and Procedures to Address and Manage Conflicts of Interest can be found in Exhibit 7 under Form NRSRO under Regulatory Affairs on **www.dbrs.com**.

and free of charge. In other words, a rating must be published in an accessible form and included in the ECAI's transition matrix. In addition, loss and cash-flow analysis as well as sensibility of ratings to changes in the underlying ratings assumptions would be made publicly available.

Technically, this means that private ratings would not satisfy these requirements. However, DBRS notes that the consultation paper is seeking comment regarding the potential flexibility for the requirements that eligible credit assessments be publicly available by adding the following footnote to the framework: "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."

DBRS utilizes the same policies, processes and methodologies including determination of the rating by Rating Committee for both public ratings and private ratings. These policies, processes, and methodologies are publicly available, on a non-selective basis and free of charge on its website, www.dbrs.com. Similar to public ratings, DBRS incorporates key assumptions and outlines the key elements underlining its private ratings. Except for private ratings and ratings for certain private placement transactions, DBRS ratings are distributed free of charge www.dbrs.com. That is, except for the public distribution of the rating, DBRS' private ratings are subject to the same rigor, conflicts of interest and integrity standards as public ratings. On this basis, both public and private ratings are included in DBRS' annual transition and default studies to reflect a complete universe of DBRS ratings.

Where the ratings process for public and private ratings is the same, DBRS suggests that the Basel rules should permit the inclusion of private ratings for regulatory capital purposes. So long as the ratings approach for public and private ratings is the same, DBRS suggests that it is prudent and safe to use third party private ratings assessments.

Cliff effects arising from guarantees and credit derivatives - Credit risk mitigation (CRM)

The current CRM rules for SA and foundation IRB banks require "eligible guarantors" to be "externally rated A- or better" or "internally rated and associated with a PD equivalent to A- or better," respectively.

To mitigate the "cliff effects" that arises when the creditworthiness of a guarantor falls below the A- level of credit quality, the consultation paper proposes to eliminate the single A minimum requirement, while maintaining a requirement in the SA that a guarantor – other than sovereigns, PSEs, banks, and securities firms - be externally rated.

DBRS believes the revised requirement will provide a more precise rating of the exposure.

Unsolicited ratings and recognition of ECAIs

As a basis for its proposals, the consultation paper indicates that the experience with the recognition of ECAIs has surfaced some concern with unsolicited ratings. It also states that the mapping of ratings should be conducted in a conservative manner given that: (i) the

methodologies upon which they (unsolicited ratings) are based are typically "point in time" and mainly based on public information; and (ii) the definition of default usually is narrower than the definition used in the context of solicited ratings by other ECAIs.

The consultation paper proposes that banks must use the chosen ECAIs and their ratings consistently for each type of claim, for both risk weighting and risk management purposes. Banks will not be allowed to "cherry-pick" the assessments provided by different ECAIs and to arbitrarily change the use of ECAIs. In addition, as a general rule, banks are encouraged to use solicited ratings from eligible ECAIs. National supervisory authorities may, however, allow banks to use unsolicited ratings in the same way as solicited ratings if they are satisfied that the credit assessments of unsolicited ratings are not inferior in quality to the general quality of solicited ratings. Where inappropriate behaviour to pressure entities to obtain solicited ratings is identified, supervisors should consider whether to continue recognising such ECAIs as eligible for capital adequacy purposes.

The characterization that the methodologies for unsolicited ratings are typically "point in time" and the definition of default usually is narrower than that for solicited ratings is not accurate for DBRS. DBRS uses the same rating definitions including the definition of default, policies, processes including determination of the rating by Rating Committee, and methodologies for both solicited and unsolicited ratings. As previously outlined, with the exception of private ratings and ratings on certain private placement transactions, all DBRS ratings are publicly available as are its definitions, policies, processes and methodologies on a non-selective and free of charge basis on its corporate website, www.dbrs.com.

DBRS appreciates the revision regarding national supervisory discretion to use unsolicited ratings that are proved to be of high quality and believes this is a positive step rather than complete disallowance. However, DBRS suggests that it would be better not to distinguish unsolicited ratings in this manner. It is important to note that in certain jurisdictions such as the U.S., unsolicited ratings are being encouraged as a means to prevent conflicts of interest, to reduce ratings shopping and to promote competition. DBRS does, however, agree that it is prudent to ensure that any unsolicited ratings that are applied should be assigned by credible, broadly recognized credit rating agencies, and that the process use to arrive at such ratings should be equivalent to that used for ratings assigned on a solicited basis.

Other comments

Revise the text to establish standard supervisory haircuts for securitization collateral

The consultation paper proposes that the following new paragraph be inserted to implement the proposed supervisory haircuts for securitisation collateral: Resecuritisations (as defined in the SF framework), irrespective of any credit ratings, are not eligible financial collateral. This prohibition applies whether the bank is using the supervisory haircuts method, the own estimates of haircuts method, the repo VaR method or the internal model method.

It is not clear to DBRS what is included or excluded from the definition of resecuritisation. DBRS would suggest that traditional ABCP be explicitly stipulated as excluded. Such assets generally performed well during the financial crisis.

DBRS would be pleased to provide the Basel Committee with additional information regarding any of its responses provided herein and regarding the securitization review. Please direct any questions about these comments to the undersigned.

Very truly yours,

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