

THE EU RATING AGENCY REGULATION

June 4, 2009

To Our Clients and Friends:

On April 23, 2009, the European Parliament adopted the European Commission's proposed new regulation on Credit Rating Agencies ("CRAs"), imposing new obligations and restrictions on CRAs in Europe. The text, as adopted by the Parliament, is available on the [Parliament's website](#).

BACKGROUND

Extensive recent press coverage of CRAs and their ratings of assets that subsequently defaulted or were seriously marked down demonstrates CRAs' crucial role in the international financial system. Used as guides by investors assessing the risk of potential investments and central to the development of the structured credit market, CRAs have been cited as one of the causes of the credit crunch.

U.S. Impulsion. The Credit Rating Agency Reform Act of 2006, which came into effect in the U.S. in June 2007, grants the Securities and Exchange Commission ("SEC") the authority to supervise and register rating agencies wishing to become Nationally Recognized Statistical Rating Organizations ("NRSRO"s). On December 3, 2008, the SEC issued new rules addressing concerns about the integrity of NRSRO credit rating procedures and methodologies. Among other things, the new rules provide for increased recordkeeping requirements, including rating upgrades and downgrades, and prohibit NRSROs from rating a security if the NRSRO has made ratings recommendations for the sponsor, underwriter, issuer or obligor or if the NRSRO employees involved in the determination of the credit rating have taken part in fee discussions, arrangements or negotiations with the issuer in question.

EU Regulation. In the context of these U.S. developments, on November 12, 2008, the European Commission published a draft regulation regarding CRAs and rating activities in Europe (the "Regulation"). The Regulation was adopted by the European Parliament on April 23, 2009.

CONTENT OF THE REGULATION

Aim. The Regulation imposes stringent requirements on CRAs in order to enhance the integrity, transparency, responsibility and reliability of credit rating activities in Europe. The

EU Commission prepared the Regulation to contribute to the smooth functioning of the European market while achieving a high level of investor and consumer protection.

Scope. The Regulation applies to credit ratings disclosed publicly or distributed by subscription that are issued by CRAs registered in the EU.

It does not apply to (i) private credit ratings provided exclusively to the person that ordered them and not intended for public disclosure or distribution by subscription, (ii) credit scores, credit scoring systems or similar assessments related to obligations arising from consumer, commercial or industrial relationships, (iii) credit ratings produced by export credit agencies, and (iv) certain credit ratings produced by central banks.

Use of Credit Ratings. The Regulation provides that when using ratings for regulatory purposes, financial institutions in the EU may use only those ratings issued by CRAs that are established in the EU and registered in accordance with the Regulation. Further, when a prospectus contains a reference to credit ratings it must also state whether those ratings are issued by a CRA established and registered in the EU.

Moreover, the Regulation provides that a CRA that endorses credit ratings issued in third countries is fully responsible for those credit ratings and for the fulfilment of conditions set forth in the Regulation.

Registration and Supervision. To enhance investor and consumer confidence in the internal market, the Regulation requires CRAs that issue credit ratings in the EU to be registered. The Committee of European Securities Regulators (CESR) will receive applications for registration and inform competent authorities in all Member States. Competent authorities of Member States will supervise CRAs in coordination with the CESR.

Independence and Avoidance of Conflicts of Interest. The Regulation sets organizational and operational requirements to ensure the independence of CRAs and improve their handling of conflicts of interest. Organizationally, CRAs must, among other things, have an administrative or supervisory board with a minimum number of independent members. The board mainly ensures (i) the independence of the rating process, (ii) the proper handling and disclosure of conflicts of interest and (iii) the CRA's compliance with the Regulation.

Operational requirements also seek to ensure independence and avoid conflicts of interest. CRAs must in particular (i) disclose conflicts of interest, (ii) disclose the names of rated entities accounting for over 5% of their annual revenue, (iii) refuse to issue or withdraw an existing

credit rating if they have an ownership interest in the rated entity, or control over the rated entity or any related third party and (iv) not carry out consultancy or advisory services.

The Regulation also imposes obligations in relation to the independence of employees responsible for the issuance of credit ratings. In addition to imposing a rotation of employees, the Regulation provides that rating analysts and employees of CRAs directly involved in credit rating activities must neither buy, sell or engage in any transaction involving any financial instrument issued, guaranteed or supported by any rated entity, nor participate in negotiations leading to the payment of fees by any such entity. In addition, the compensation and performance evaluation of rating analysts and persons approving the credit ratings must not be contingent on the amount of revenue that the CRA derives from the rated entities or related third parties.

Rating Methodologies. The Regulation imposes numerous requirements relating to rating methodologies so as to ensure the transparency and reliability of credit ratings. It requires in particular that CRAs publicly disclose their methodologies, models and key assumptions and ensure that their credit ratings are based on sufficient and reliable information. The Regulation also requires CRAs to monitor and review their methodologies on an ongoing basis and at least annually.

Disclosure and Presentation of Credit Ratings. The Regulation provides that CRAs must disclose, among other things, (i) all credit ratings they issue as well as any decision to discontinue a rating, (ii) all material sources, the meaning of the rating categories used and the date credit ratings are released and updated, (iii) information as to whether a credit rating concerns a newly issued financial instrument and whether the CRA is rating the financial instrument for the first time and (iv) any reservation or limitation they may have on the ratings.

The Regulation also imposes certain requirements as to the presentation of credit ratings to ensure transparency. In particular, structured products must be clearly identified as such by the use of a specific symbol which distinguishes them from rating categories used for any other entities. Furthermore, where a CRA issues credit ratings of structured finance instruments, it must accompany the disclosure of methodologies, models and key rating assumptions with guidance explaining them, including simulations of stress scenarios undertaken by the agencies when establishing the ratings. CRAs must also identify unsolicited credit ratings within a different category and specify whether or not the issuer participated in the rating.

Further Transparency Obligations. To improve transparency, CRAs must publicly disclose specified additional information, including (i) the fact that they are registered in accordance with the Regulation, (ii) an overview of their compensation arrangements, (iii) any material modification to their systems, resources or procedures and (iv) data about the historical default rates of their rating categories.

CRAs must further publish annually a transparency report, including information on the ownership and legal structure of the agency, a description of the internal quality control system and financial information on the revenue of the agency.

Implementation. The Regulation will enter into force later this year, on the twentieth day following its publication in the Official Journal of the EU. Member States will have six months to take the necessary measures to implement its provisions. With respect to the use of credit ratings issued by agencies outside of the EU, the Regulation will apply as of 18 months after its entry into force.

Please feel free to contact us with any questions.

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