

**Presentation to the European
Parliamentary Financial Services Forum**

on

RATING AGENCIES

by

**Paul Taylor
Group Managing Director
FITCH RATINGS**

20 MAY 2003

**Fitch Ratings Limited
Eldon House
2 Eldon Street
London EC2M 7UA
Telephone: +44 (0) 207 417 4222
Fax: +44 (0) 207 417 4242
www.fitchratings.com**

Paper Outline

	<u>Page No</u>
1. General Overview of Ratings and Fitch	3
2. Use of Ratings	4
a. By issuers	4
b. By investors	5
c. By intermediaries	6
d. By rating analysts	6
e. In private contracts	6
3. Publication and Distribution of Ratings	7
a. Selective disclosure of ratings	7
b. Timing requirements for the release of publications	8
4. Issuer Contact and Involvement	8
a. Issuer input into the ratings process	8
b. Access to nonpublic information	9
5. Disclosures by Rating Agencies	9
a. Premature disclosure of nonpublic information	10
6. Fitch Initiated or “Unsolicited” Ratings	10
7. Information Verification Mechanisms	10
8. Ratings Fees and Potential Conflicts	11
9. Regulation of Rating Agencies	12
Appendix – Fitch rating definitions	

1. General Overview of Ratings and Fitch

Fitch is in the business of publishing research and independent ratings and credit analysis of securities issued around the world. A rating is our published opinion as to the creditworthiness of a security distilled in a simple, easy to use grading system (“AAA” to “DDD”). In this manner, ratings are used to help price and market new securities issues and trade such issues in the secondary market. Ratings have also become commonplace outside of the capital markets and are frequently incorporated in loan documents (particularly syndicated loans), bilateral swap agreements, and general counterparty agreements. The interbank market is also heavily reliant on ratings.

Fitch gathers and analyzes a variety of financial, industry, market and economic information, synthesizes that information and publishes independent, credible assessments of the creditworthiness of securities and issuers thereby providing a convenient way for investors to judge the credit quality of various alternative investment options. Fitch also publishes considerable independent research on credit markets, industry trends and economic issues of general interest to the investing public.

By focusing on credit analysis and research, Fitch provides independent, credible and professional analysis for investors more efficiently than the investors could perform that analysis themselves.

Fitch Ratings traces its roots to the Fitch Publishing Company established in 1913. In the 1920s, Fitch introduced the now familiar “AAA to D” rating scale. Fitch was one of the three rating agencies, together with Standard & Poor’s and Moody’s Investors Service, first recognized as a nationally recognized statistical rating organization (NRSRO), by the United States Securities and Exchange Commission in 1975. Fitch and its affiliates also are recognized by a number of regulatory authorities throughout the world.

From the early 1990s onwards, Fitch has experienced dramatic growth, especially in the new area of structured finance. In 1997, Fitch merged with IBCA Limited, another international rating agency headquartered in London. Through the merger with IBCA, Fitch became owned by Fimilac S.A., a French holding company which acquired IBCA in 1992. The merger of Fitch and IBCA represented the first step in our plan to respond to investors’ need for an alternative global, full service rating agency capable of successfully competing with Moody’s and S&P across all products and market segments.

In 2000, Fitch completed the acquisitions of Duff & Phelps Credit Rating Co. and the rating business of Thomson BankWatch, both international rating agencies with worldwide operations. These acquisitions strengthened our coverage in the corporate, financial institution, insurance and structured finance sectors, as well as adding a significant number of international offices and affiliates.

Today, Fitch has a global position across virtually all markets and products. Fitch maintains dual headquarters in New York and London, as well as over 40 offices and affiliates worldwide. With approximately 1,350 employees and 750 analysts, Fitch provides analytical coverage on approximately 2,300 banks and financial institutions, 1,000 corporations, 80 sovereigns, 7,000 issues in structured finance and well over 26,000 municipal and subnational offerings.

Currently, we have over 5,000 institutional investors, financial institutions and government entities subscribing to our research and ratings and thousands of investors and other interested parties that access our ratings, criteria and methodology, as well as many topical research publications, on our free website and through other published sources and wire services such as Bloomberg, Business Wire, Dow Jones, and Reuters.

2. Use of Ratings

a. By Issuers

Fitch believes that ratings are widely sought by issuers throughout the world because ratings are used by a diverse mix of both short-term and long-term investors as a common benchmark to grade the credit risk of various securities. Accordingly, issuers and their agents seek ratings because investors use them. Ratings are used to help market and price new securities. Ratings also are used to help price securities traded in the secondary market. In support of our belief, many independent studies have confirmed that liquidity is enhanced and pricing is more favorable when a security has one or more rating.

Fitch believes that ratings are often disclosed in offering materials distributed in connection with the issue of a security and published in issuers' annual reports and similar publications. Ratings also frequently appear in published reports about securities carried by the financial press.

In addition, ratings have become increasingly incorporated in loan agreements, derivative financial transactions and other counterparty agreements. Ratings are often incorporated in collateral arrangements that govern the collateral supplied to counterparties in the derivative and securities markets. Ratings are also used in the interbank market by banks judging the creditworthiness of other banks with which they transact business. Consequently, ratings usage by issuers is increasingly not specific to a capital markets debt offering, but sought out as a measure to assure counterparties of the general creditworthiness of the issuer.

While there are certain jurisdictions where ratings are mandatory, the mandatory use of ratings is not common. Throughout the world, ratings are used in safety and soundness and eligible investment regulations for banks, insurance companies and other financial institutions. As a result, the use of ratings in regulation does contribute to some extent to issuers seeking ratings but it is likely

that the vast majority of entities would maintain ratings anyway, notwithstanding the regulatory use. Investment guidelines and objectives of many large institutional investors and mutual funds incorporate ratings in setting eligibility requirements for purchasing or holding a specific security, also prompting an issuer to desire a rating.

b. Use of Ratings by Investors

As mentioned above, Fitch believes that ratings are used by a diverse mix of both short-term and long-term investors worldwide because they provide an easy to use, common benchmark to grade the credit risk of various securities. In addition to their ease of use, efficiency and wide spread availability, we believe credit ratings are most useful to investors because they allow for reliable comparisons of credit risk across diverse investment opportunities available throughout the world.

In addition, credit ratings accurately assess credit risk in the overwhelming majority of cases. Credit ratings have proven to be a reliable indicator for assessing the likelihood that a security will default. Fitch’s most recent corporate bond and structured finance default studies are summarized below.

Fitch Average Annual Default Rates

	Corporate Finance* 1990-2001	Structured Finance** 1991-2001
AAA	0.00%	0.00%
AA	0.00%	0.01%
A	0.05%	0.01%
BBB	0.36%	0.11%
BB	1.94%	0.31%
B	2.54%	1.24%
CCC - C	26.53%	20.88%
Investment Grade	0.12%	0.02%
Non Investment Grade	4.20%	1.27%

* Based on Fitch-rated global corporate debt issuers (includes banks & insurance entities)

** Based on Fitch-rated US structured finance bonds.

Although other methods can be used to assess the creditworthiness of a security, such as the use of yield spreads and price volatility, we believe that such methods, while valuable, lack the simplicity, stability and track record of performance to supplant ratings as the preferred method used by investors to assess creditworthiness.

For all of these reasons we believe investors worldwide use ratings.

In addition, there are investors that must comply with regulatory requirements as well as their own published investment guidelines and objectives that, at least in part, use ratings as a reference base. This further increases investor demand for ratings.

c. Use of Ratings by Intermediaries

Ratings accurately and efficiently assess credit risk and therefore are commonly incorporated in explicit risk management policies, as well as in ordinary risk exposure management used by financial institutions worldwide.

In addition, as discussed above, counterparty eligibility is frequently based on ratings and collateral posting requirements may also be ratings-based.

Fitch also believes that intermediaries acting as arrangers, managers and underwriters of securities offerings refer to ratings in their offering materials for new securities.

d. Use of Ratings by Analysts

Fixed income analysts are active users of ratings in conjunction with their own independent research and ratings are typically published in their analytical research reports. Most commonly, analysts use our ratings to identify securities that they believe have a different risk exposure than the rating reflects, securities that the marketplace trades at prices and spreads that are inconsistent with the rating, relative pricing differences between securities of otherwise similar ratings and risk characteristics and securities that they feel may be subject to future rating actions. In this context, fixed income analysts working for intermediaries may use ratings as basis for their fixed income securities recommendations.

e. Use of Ratings in Private Contracts

Ratings are used in financial contracts in a variety of different ways.

Syndicated loan agreements typically contain covenants related to ratings that may affect pricing as well as funds availability. More recently, loans began to include so-called ratings triggers which are events, such as maturity acceleration, based on a change in the borrowers rating level. Fitch conducted a survey in 2002 to assess how widespread such ratings-based triggers were in loan documents and found that ratings triggers were generally not part of the leveraged and high-yield loan market, but were fairly common in investment grade syndicated loans. However, more recently, Fitch has noticed that ratings triggers are being used less frequently in syndicated lending. Conversely, loan pricing still remains frequently ratings based.

Counterparty eligibility to participate in derivative transactions is routinely based on ratings and collateral arrangements and mark-to-market adjustments included in derivative contracts are often formula-based according to the counterparty's

ratings. Finally, participation in the interbank market is predominantly ratings based.

3. Publication and Distribution of Ratings

By policy, all rating actions and affirmations on public ratings are publicly communicated. Fitch has internal policies that govern the content, form, and style of ratings and commentary, as well as the manner in which they are disseminated to the public, subscribers, and issuers. Our policies are designed to assure consistency of procedures as well as accuracy and timeliness. In a few markets, due to regulatory or legal requirements, some procedures may vary slightly. In 2002, Fitch published over 10,000 items, principally ratings related. All of these were posted to our global website (www.fitchratings.com) and made available to news services for distribution throughout the world. In addition, items of local interest are also posted to one of the 15 local websites we maintain in seven different languages, including websites devoted to our subsidiaries in Australia, Brazil, France, Germany, Italy, Japan, Mexico and Spain, to name a few.

Fitch's ratings and related communications, such as rating actions, are widely available through our public websites free-of-charge and there are no prior communications of rating actions to subscribers. Criteria and methodology reports, as well as industry and general topical research, also are freely available on our websites. However, more detailed commentary about rated entities and other proprietary research is available only to subscribers.

a. Selective Disclosure of Ratings

As discussed above, all public ratings and rating actions are widely disseminated through our websites and international wire services. Except for prior notification to the issuer of a rating or rating action discussed below, ratings and rating actions are never selectively disclosed to any subscriber or any other party.

Fitch analysts do regularly conduct informal conversations with investors, other members of the financial media and interested parties discussing our analysis and commentary, but as a matter of policy those conversations can never go beyond the scope of our published analysis or communicate any non-public information. We believe that the free access to our analysts by anyone interested in discussing our analysis is a valuable service to the investing community and the capital markets at large. The contact information for the principal analysts and other key contact people at Fitch is included in every item we publish for the purpose of facilitating interested parties posing questions to our analysts. Anyone can call our analysts free of charge and discuss our analysis with them, whether or not the person is a subscriber to our subscription services.

From time to time, we also hold free telephone conferences that also are available to anyone interested at which our analysts will discuss our published analysis and criteria and take questions from the participants. These telephone conferences are publicly announced in the same manner our ratings and rating actions are disseminated.

We also sponsor conferences throughout the world, as well as participate in conferences sponsored by others (which may sometimes require payment of a registration fee) at which our analysts will discuss our published analysis and criteria. All of these conferences are publicly advertised and all are welcome.

b. Timing requirements for the Release of Publications

Fitch's practice is to endeavor to release any publication with respect to a rating action within the same day that the publication is cleared for publication by our editorial process. We do not restrict publication to certain times of the day.

4. Issuer Contact & Involvement

The rating process usually includes an active dialogue with an issuer, and in some instances their adviser, that entails an exchange of information between the issuer and Fitch. Meetings with management may be conducted on their premises or in our own offices and typically occur annually, although it is common for active issuers to have more frequent meetings, sometimes as often as quarterly. Interim telephone contact and electronic correspondence are typical for most issuers and are part of the routine surveillance of an issuer and rating. While access to senior levels of management at an issuer is beneficial, an objective opinion about an issuer can be formed based solely on public information in many jurisdictions. Fitch Initiated Ratings (as described in our response above) may or may not entail contact with senior management.

a. Issuer Input to the Ratings Process

Fitch's practice is to provide issuers advance notice of a rating or rating change and an advance copy of our publication prior to its release. We engage in this practice to check the factual accuracy of our publication with the issuer as the issuer is often the source of a significant amount of the factual material included in our publications. This practice also permits the issuer the opportunity to verify that the publication does not inappropriately publicly disclose nonpublic information that it believes ought to remain nonpublic. It is incumbent on the issuer to respond in a timely manner with any comments they might have as we strive for a same day release of any ratings related publications. The purpose of this practice is solely to verify the accuracy of our publication, not to seek the issuer's permission to publish or to permit the issuer any control over the editorial content of our publication.

Although infrequent, there are occasions on which we determine as a matter of our editorial judgment that a publication should be released without prior notice

being given to the issuer (or in some cases very short notice) or providing an advance copy of the publication to the issuer for factual verification.

Under certain circumstances if an issuer objects to a rating action, it is Fitch's practice to permit the appeal of a rating decision and to provide the issuer with the opportunity to supply additional information that may influence the rating.

b. Access to Nonpublic Information

Rating agencies gather and analyze a variety of financial, industry, market and economic information, in order to form their ratings opinion. Nonpublic information frequently includes budgets and forecasts, as well as advance notification of major corporate events such as a merger. Nonpublic information may also include more detailed financial reporting than an issuer otherwise publicly discloses.

While access to nonpublic information and senior levels of management at an issuer is beneficial, an objective opinion about the creditworthiness of an issuer can be formed based solely on public information in many jurisdictions. Typically, it is not the value of any particular piece of nonpublic information that is important to the rating process, but that access to such information and senior management can assist us in forming a qualitative judgment about an issuer's management and prospects.

The nature and level of nonpublic information provided to Fitch varies widely by company, industry, and country. As a matter of policy, all information presented to Fitch in connection with ratings and analysis is kept confidential. Strict procedures are in place to prevent the possibility that nonpublic information can be abused. Prior to publication, ratings and supporting commentary are subject to internal reviews and checks, as well as submission to the issuer, in order to avoid the unintentional disclosure of nonpublic information.

5. Disclosures by Rating Agencies

When Fitch publishes a rating action it provides commentary and financial analysis that explains the relevant rating action and the factors leading to the particular rating. Many quantitative and qualitative factors comprise a rating decision. Quantitative factors include historical and current financial performance, assumptions and expectations, trends and momentum and peer rankings, all of which are detailed and discussed as appropriate in our publications in order to explain and support the published ratings.

We believe that the processes and procedures that rating agencies use should be as transparent as possible. Accordingly, at Fitch there are literally hundreds of published criteria reports highlighting the methodology used to rate various types of entities and securities, together with detailed sector analysis on a broad array of sectors, companies, and issues, all available free on our websites.

a. Premature Disclosure of Nonpublic Information

As a matter of practice, we do not generally report on nonpublic matters or disclose nonpublic matters before the issuer discloses such matters. However, if we believe a matter of significant public interest should be disclosed by an issuer, we reserve the right to publicly disclose the matter in our published materials if they do not disclose it. In the context of a merger, acquisition, sale or other significant transaction or event, it is our practice to comment on the transaction only after it has been disclosed by the issuer.

6. Fitch Initiated or “Unsolicited” Ratings

As members of the financial media, Fitch reserves the right to publish our opinion as to any issuer or issue that we determine to be of interest to the investing public. In 2001, Fitch introduced its Fitch Initiated Ratings (FIR) program. Fitch Initiated Ratings target high profile market participants or issuers with discrepancy in market opinions not traditionally rated by Fitch. Ratings which are initiated under this program are identified as such in the original publication concerning the rating. Fitch will only publish a FIR if we conclude that there is sufficient information available to us to allow us to express our opinion, and in all cases, such ratings are uncompensated and Fitch does not assess or seek fees for the analysis done in connection with these ratings.

There is no difference in the analytical process or criteria for Fitch Initiated Ratings, although the level of management involvement varies. Procedures relative to the publication of the ratings are also the same and we contact the issuer prior to publishing a new rating established or subsequent rating action to the marketplace.

7. Information Verification Mechanisms

As stated in our published Rating Definitions, Fitch does not verify the truth or accuracy of information used in the rating process. Rating agencies generally operate with the understanding that information can be provided to a rating agency without necessitating an intrusive and expensive verification process that would largely if not entirely duplicate the work of other professionals in the issuance of securities. Thus Fitch does not perform due diligence and assumes the accuracy of the information that is provided to us by issuers and their advisors. We believe our practices in this regard are entirely consistent with those of the other international rating agencies.

Fitch’s rating process is to perform consistent, ongoing analysis on a rated entity throughout the duration of the rating relationship. The rating process typically includes regularly visiting rated issuers, maintaining contacts with the members

of the finance staff and other important personnel at those issuers and staying current on events affecting the issuers, relevant industries and the economic issues. Typically, a lead analyst and a backup analyst maintain coverage of an issuer and are responsible for ongoing analysis, rating proposals, and published credit commentary about the issuer. As part of this rating process the analysts are responsible for assuring that key assumptions and expectations are still relevant. Ratings also are subject to periodic formal review and presentation to a credit committee. All of Fitch's rating decisions are made by rating committees, not by individual analysts.

As stated in our published ratings definitions, the maintenance of a rating is contingent upon the availability of current financial information acceptable to us and availability of other information we deem necessary to maintain a rating. Current financial information for most issuers would include interim financial statements, audited annual financial statements, and contact with senior management including (at a minimum) attendance at an annual meeting with management.

On a portfolio basis, we monitor rating accuracy by tracking transition and default rates which are measured against rating grades. These transition and default rates are published annually by Fitch. The most recent default rates are referenced above.

8. Ratings Fees and Potential Conflicts

Fitch receives fees from two principal sources: issuers of securities and subscribers to our publications. Currently about 90% of our revenue comes from fees from issuers. Our subscription revenue accounts for the remainder of our revenue and comes from institutional investors, financial institutions and government entities.

Charging a fee to the issuer for the analysis done in connection with a rating dates back to the late 1960s. The fees Fitch receives are agreed upon in advance of the rating analysis and the determination of the rating and are not based on the success of a bond issue or tied to the level of the rating assigned. We also do not charge a fee for a rating unless the issuer agrees in advance to pay the fee. Fee schedules are published and Fitch has largely separated fee negotiation from the analysts' role through the formation of a marketing group. In some instances, fees may be negotiated or arranged with a very senior member of an analytical group (such cases are usually in smaller offices without dedicated marketing staffs and structured finance), but these senior members do not have direct analytical coverage or responsibilities for that respective issuer. Our fees vary depending on the type of issuer and the nature of the issue. We also negotiate annual fees with certain large issuers in lieu of issuance fees.

Typically, fees for corporate finance issuers range from \$30,000 to \$250,000 and for structured finance fees range from \$25,000 to \$750,000.

The amount of revenue Fitch receives from issuers covered by an analyst is not a factor in that analyst's compensation. Instead, an analyst's performance, such as the quality and timeliness of their research and the overall financial performance of Fitch determine an analyst's compensation. Similarly, an analyst's performance relative to their peers and the overall profitability of Fitch determine an analyst's bonus. The financial performance of an analyst's sector or group does not factor into their bonuses.

9. Regulation of Rating Agencies

Fitch continues to maintain dialogue with governments and agencies worldwide regarding regulatory matters and welcomes open discussion. We are therefore an active participant in the current debate about regulating rating agencies. Within this, we take a strong stand that regulators should not attempt to influence rating opinions: it is the independence of these opinions that makes them so valuable to market participants.