



Date of Commentary: November 30, 2009

## How DBRS Maintains Independence and Ratings Quality

Two questions frequently asked of credit rating agencies (CRAs) are “How do you maintain your independence?” and “What are you doing to ensure ratings quality, especially in Structured Finance?” DBRS’s responses centre on how it manages the potential for conflicts of interest in its business and on the public transparency and disclosure of its rating policies, processes and methodologies and of its reporting and publishing of rating performance data.

### Managing Potential Conflicts of Interest

There is no business model, be it issuer-pay, investor-pay or subscriber-pay, that completely avoids the potential for conflicts of interest. Rather, the question is whether there are processes, policies and procedures in place that identify, manage and monitor the potential for conflicts throughout the firm. The DBRS business model is issuer-pay, which allows ratings to be available to all investors without cost. When all market participants receive ratings simultaneously, they have received an additional source of information, a risk and comparative tool to use in their decision making. In the subscriber-pay model, subscribers may have a stake in how an issuer or instrument is rated and rating accuracy is difficult to verify because of the limited disclosure to the public, especially smaller investors.

DBRS has spent considerable effort to strengthen its standards and internal governance to prevent and manage the potential for conflicts of interest. These include the following:

- A global organizational and committee structure that prohibits and separates analytical staff from being involved in any aspect of the fee process – initiating, arranging, negotiating or participating in discussions or payments for ratings with issuers or potential issuers that may seek a DBRS rating.
- Criteria review functions for each of DBRS Corporate Finance and Structured Finance groups that review and approve all new and revised models and methodologies before they are published.
- Restrictive personal investment and trading rules for management and staff at all levels of the firm.
- “Look-back” reviews when an analyst leaves DBRS for a role at an issuer he or she rated.
- Prohibiting analytical staff from accepting gifts or entertainment from anyone with whom DBRS does business other than items provided in the context of normal business activities, such as meetings, that have an aggregate value of no more than \$25.
- Reinforced policies and procedures so there is no advising, recommending or consulting in the rating process for Corporate Finance and Structured Finance.
- A broad Confidential Information Framework to reduce the risk of conflicts of interest arising.
- Global compliance group with reporting lines and compensation independent of DBRS rating operations and commercial activities.
- Global compliance program that includes an Employee Code of Conduct, Conflicts of Interest and Confidential Information Frameworks (the Frameworks) and a Violations Reporting Policy monitored on an ongoing basis by DBRS’s Chief Compliance Officer.
- Publicly available *DBRS Business Code of Conduct* (Business Code) that reflects the International Organization of Securities Commissions (IOSCO) Code of Conduct Fundamentals for Credit Rating Agencies (IOSCO Code), U.S. Securities and Exchange Commission (SEC) rules<sup>1</sup> and DBRS best practices.

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<sup>1</sup> Rules for registered Nationally Recognized Statistical Rating Organizations (NRSROs) pursuant to the *Credit Rating Agency Reform Act of 2006*.



The European Union has introduced a new regulatory regime for CRAs (EU CRA Regulation). DBRS is an active participant in the Committee of European Securities Regulators (CESR) CRA Consultative Working Group (CESR CWG), which provides ongoing advice and consultation relating to the implementation and application of the EU CRA Regulation and related rules and guidance. The EU CRA Regulation has specific requirements regarding conflicts of interest. There are also various proposals in the United States regarding conflicts of interest.

DBRS is in the process of determining additional adjustments to its Frameworks and related policies and procedures to ensure it meets applicable regulatory requirements and maintains best practices and high standards for independence.

### **Transparency and Disclosure**

Ratings quality, or Getting the Rating Right, is a core DBRS value. DBRS believes that a high level of transparency in the rating process not only drives quality ratings but also assists in managing the potential for conflicts of interest. Transparency is something DBRS takes very seriously. DBRS has focused its efforts on providing significant additional disclosure of all aspects of the rating process, with particular attention to Structured Finance. To ensure market participants have a clear understanding of its rating approach, DBRS publishes its rating philosophy, rating scales, rating definitions and rating processes under [Rating Policies](#) on our website.

#### ***Structured Finance Rating Differentiation***

For simplicity, Corporate Finance and Structured Finance ratings use the same short-term and long-term rating scales. As a means to differentiate its ratings, each DBRS rating press release specifies the type of rating being published, such as whether it is a Structured Finance rating, a Financial Institutions rating or a Public Finance rating. The EU CRA Regulation will require additional disclosure regarding Structured Finance ratings in the form of a modifier that would clearly denote the rating as such. This modifier is not intended to change the meaning of the rating. Other international jurisdictions are also evaluating this requirement. At present, DBRS clearly notes in each press release whether the rating assigned is a Structured Finance rating. DBRS is in the process of determining its supplementary approach and plans to notify the market of any changes prior to its implementation.

#### ***Structured Finance Information Review***

As noted in its Business Code, DBRS implemented the Structured Finance Information Review Policy, which outlines the measures it adopted to ensure the information it uses in assigning a rating is of sufficient quality to support a credible rating. These measures include the review of asset data, legal documents and client information.

#### ***Surveillance***

Surveillance is an integral part of DBRS's standard rating process in order to maintain the accuracy of its rating opinions. To heighten transparency, DBRS has published its policy on Structured Finance surveillance, which outlines how it monitors all of its outstanding Structured Finance public and private ratings on a regular basis.

Over the past year, DBRS has enhanced its monthly securitization servicer and surveillance reports for Canadian asset-backed securities (ABS), Canadian asset-backed commercial paper (ABCP), structured notes and global commercial mortgage-backed securities (CMBS). These reports, found on our website under [Monthly Reports](#), provide comprehensive market summaries, rating actions and granular deal-level performance metrics. They do not replace but rather supplement the rating reports and performance update reports that DBRS publishes on rated transactions. For CMBS, DBRS provides the Annex A Advisor tool for investors to transparently run what-if scenarios on their CMBS portfolios.



In response to market-wide consultations, DBRS plans to increase the level of ABCP surveillance reporting with an enhanced report, which will be available on our website in early 2010. DBRS will continue to have ongoing dialogue with investors to further enhance monthly reporting for other asset classes.

#### ***ABCP Reporting***

During 2009, DBRS revised its Canadian bank-sponsored ABCP rating reports to enable investors to better understand the factors that DBRS considers in determining the ratings of the various series of notes issued by each conduit. Key analytical features of the revised reports include details of the underlying structure of each conduit, the nature of 100% of the transactions into which it enters, the asset pool composition as of the report date, loss and other relevant performance metrics, links to the DBRS methodologies used as part of the rating review and the minimum rating requirements for the various counterparties that support the conduit.

A detailed analysis of the underlying liquidity agreements is also provided, including the disclosure of the liquidity draw conditions, the identity of the liquidity providers, a description of the nature of the liquidity, the minimum levels of liquidity available and the renewal process.

DBRS also increased the coverage of its ABCP issuers in the monthly *DBRS Commercial Paper Issuers* report by adding sponsor, liquidity coverage, Global Liquidity Standard (GLS) compliance, liquidity providers and ABCP outstandings.

#### ***Rating Methodologies***

DBRS publishes methodologies for all industries and product groups it covers. These can be found under **Methodologies** on our website. In addition, each DBRS rating press release specifies the criteria and methodology used in the analytical process and provides a direct link to the methodology. Over the last 12 months, DBRS has updated a wide range of Structured Finance criteria and methodologies for the Canadian and the U.S. markets in the following areas:

- **ABCP**
- **Auto ABS**
- **CMBS**
- **Covered Bonds**
- **Credit Card & Consumer Lending**
- **Equipment**
- **RMBS**
- **Split Shares & Funds**
- **Structured Credit**
- **Student Loans**
- **Other**

Currently, the following methodologies have been published for public comment:

- *Rating U.S. Retail Auto Loan Securitizations*
- *U.S. Wholesale Auto ABS Securitizations*
- *Rating U.S. Equipment Lease and Loan Securitizations*
- *U.S. Rental Car ABS Criteria*

DBRS also published updated methodologies in its **Corporate Finance**, **Financial Institutions** and **Public Finance** industry groups as well as global **General Corporate** methodologies that apply across industries and product groups.



### ***Bank Support Assessment Rating Methodology***

In February 2009, DBRS published *Enhanced Methodology for Bank Ratings – Intrinsic and Support Assessments*. The enhancement refines DBRS’s support methodology by introducing a floor rating concept for banking organizations that are considered critically important to the functioning of a country’s financial markets.

To date, this methodology has only been applied to a select population of banks and the methodology is clearly noted in each related DBRS press release. Virtually all banks are assigned both a support assessment (SA) rating of SA1 to SA4 and an intrinsic assessment (IA) rating that reflects DBRS’s opinion of a bank’s intrinsic fundamentals, which would include explicit government support that is actually in place. The SA essentially clarifies DBRS’s view as to the likelihood and predictability of timely explicit or implicit external support for a bank in case of need. Should policy-makers and regulators act to remove future or implied support from the banking system, DBRS will reconsider its SA methodology.

To avoid any confusion with the introduction of a parallel scale, the IA ratings use the DBRS long-term rating scale. DBRS views both the IA and SA ratings as “building blocks” that, taken together, result in the final ratings for a bank. DBRS’s approach to presenting this information has been to publish a bank’s final ratings in the rating table that appears on all press releases and rating reports, with any discussion on the IA and SA building blocks contained in the text. DBRS believes this approach provides valuable information to the investor without the possibility of confusion that may occur should the IA rating be included in the rating table, given the use of a common rating scale.

### ***Performance Data***

On an annual basis, DBRS publishes default and transition studies (found under [Rating Studies](#) on our website) for each of its Corporate Finance and Structured Finance groups to provide a transparent benchmark of its rating performance.

In compliance with a new SEC rule adopted in February 2009,<sup>2</sup> DBRS makes publicly available a randomly generated sample of 10% of its entire history of rating actions for Corporate Finance and Financial Institutions and for Structured Finance that allows investors, regulators and other market participants to compare ratings of Nationally Recognized Statistical Rating Organizations (NRSROs) at any point in time. The DBRS Rating History Samples can be found under [Regulatory Affairs](#) on our website.

On November 23, 2009, the SEC adopted a new rule that requires all NRSROs to publicly disclose rating action histories for all credit ratings initially assigned on or after June 26, 2007, in an interactive data file that uses a machine-readable format (“100% requirement”).<sup>3</sup> DBRS will provide this additional public disclosure on our website in line with the compliance date to be established for the 100% requirement.

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<sup>2</sup> SEC Rule 17g-2 was amended to require NRSROs to make publicly available, on a six-month delayed basis, rating action information for a random sample of 10% of their issuer-paid credit ratings. An issuer-paid rating is a rating paid for by the obligor being rated or by the issuer, underwriter or sponsor of the security being rated. The 10% sample applies to each class of credit rating for which the NRSRO is registered and each class for which it has issued 500 or more issuer-paid ratings.

<sup>3</sup> SEC Rule 17g-2 was amended for the 100% requirement, to be made publicly available on a delayed basis. In the case of issuer-paid credit ratings, each new rating action will be required to be reflected in such publicly disclosed histories no later than 12 months after it is taken, while in the case of rating actions that are not issuer-paid, each new rating action will be required to be reflected no later than 24 months after it is taken. NRSROs are permitted to use any machine-readable format until 60 days after the date the SEC publishes a list of eXtensible Business Reporting Language (XBRL) tags on its website.



DBRS also provides performance data information to international regulators as part of maintaining its registrations, recognitions and approvals. **Highlights** can be found on our website under Regulatory Affairs.

Under the EU CRA Regulation, CESR is in the process of developing common measures to enhance rating performance data comparability. In the longer term, CESR is developing a central repository (CRep), where CRAs would make available their historical rating performance data in a standardized form, that would be accessible to the public. As a member of the CESR CWG, DBRS is a contributor to the development of the common measures and the CRep.

DBRS plans to publish additional and more frequent rating performance data and commentary in 2010.

### **DBRS Commitment**

Ratings provide an important information role in the market. DBRS will continue to dialogue with investors, legislators, regulators and other market participants to address their concerns regarding independence and ratings quality to help restore investor and financial market confidence.

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