STANDING FOR TRUST AND INTEGRITY

Federation des Experts comptables Européens –
Federation of European Accountants (AISBL)

CORPORATE REPORTING

FOR THE FUTURE

Conference in Brussels, Tuesday 18 September 2012

DISCLAIMER

This presentation is the personnal opinion as an expert of Nicolas d'Hautefeuille, head CA CIB's rating advisory team. This presentation does not reflect any implicit or explicit opinion of the Credit Agricole's group on regulation issues.

WHERE DO WE GO FROM HERE?

From vision to next practical steps

What can be done in the short and medium term

to work towards the longer term vision?

MORE TRANSPARENT ACCOUNTING

is a key step

to transform ratings

FROM AN ART TO A SCIENCE

Executive Summary

1. The accounting problem for CRAs: strong methodologies are based on transparent accounting

2. The accounting problem for issuers: benchmarking is the key step to secure fair ratings

3. The regulatory issue: enhancing accuracy in global rating scale

BACK TESTING based on rule 8-3 is the best way to improve « accuracy ratio »

RATING WAS AN ART BUT MUST BECOME A SCIENCE

1. SCORING: STRONG METHODOLOGIES ARE BASED ON TRANSPARENT ACCOUNTING

- **Step1: Adjustments on credit metrics**
  - Rating agencies « reconciliate » cash flow statement
  - Appendix provides the right information to « clean » ebitda » and to « adjust » debt

- **Step2: Stress testing on projections**
  - Leverage is based on « stress testing » on the ability to generate free operating cash flow at the bottom of the cycle
  - Equity is not perceived as relevant because it is mainly impacted by non cash and non recurring items

- **Step3: Ratings are based on transparent criteria**

1. Business risk *ie ability to generate free operating cash flow in a stress scenario*
2. Financial risk *ie ability and willingness to deleverage*
3. Liquidity risk *ie vulnerability to the credit cycle*
4. Notching *ie reconciliation between probability of default and probability of loss*

Scoring is the best way to transform rating from an art to a science

2. BENCHMARKING remains an art but helps to secure « fair » ratings for European issuers

- **The problem for rating agencies: reconciliation between US GAAP and IFRS requires non standard adjustments**

  - « Standard » adjustments on debt are driven by the idea that « debt » is not a legal or accounting risk but an economic risk ie what are the fixed charges that must be paid in a stress scenario?
  - Non standard adjustments on « clean » ebitda » are even more important to adjust credit metrics

- **Our value as rating advisor: to help European issuers to secure « fair » ratings**

  - We are helping corporates to check that their credit metrics are consistent with their competitors
  - The « reconciliation » between IFRS and US GAAP remains a minor issue compared to the « black box » on Asian issuers

Rating advisory is based on our ability to manage « gentleman disagreements » with CRAs

3. BACK TESTING based on rule 8-3 is the best way to improve « accuracy ratio »

- **Rating agencies will act as efficient « passports of credit » if and only if rating scales are accurate on a global basis**

  1. Fraud was historically the major credit risk
  2. « Recalibration » based on the global rating scale has supported ratings for US municipal bonds

- **Where do we go from here? From vision to next practical steps?**

  The regulatory issue is not only to increase competition but even more to improve the accuracy in the rating scale as a way to help investors to make the difference between liquidity risk and solvency risk

More efficient "back testing" will create a "win / win" situation for both investors / issuers, and auditors / regulators