

Mr Carlo Comporti
Acting Secretary General
European Securities and Markets Authority

Brussels, 24 January 2011

Subject: *ESMA Call for Evidence on the criteria for endorsement (Article 21(2)(a) of the draft amended CRA Regulation)*

Dear Mr Comporti,

The European Banking Federation welcomes ESMA's call for evidence on the criteria for endorsement pursuant to Article 21(2)(a) of the draft amended CRA Regulation. Whilst the EBF, as a trade association, is not in the position to provide concrete figures in response to the current consultation, we wish to reiterate the concerns we have previously flagged to the European Commission.

The EBF, indeed, wrote to the Commission at the beginning of November last year to underline its disagreement with the current interpretation of the endorsement process. We continue to believe that the endorsement process was created as a deliberately flexible mechanism to allow the continued use of all ratings issued by the largest credit rating agencies, subject to these CRAs assuming responsibility for the application of requirements "at least as stringent as the requirements" applicable within the EU, irrespective of the country of issuance of the rating or of the analyst's location. The European banking industry is therefore of the opinion that the process that applies currently and until the expiration of the transition period to the endorsement of non-EU ratings is the democratically legitimate permanent solution.

Furthermore, the EBF raised concerns about the potential economic effects of an interpretation that would lead to the de-recognition of ratings issued in non-EU and non-equivalent jurisdictions, in view of the additional capital requirements that this would imply for the European banking industry; in times where banks are already struggling to meet the higher capital requirements and other charges imposed on them as a result of parallel discussions. In this light, the EBF would in particular reiterate the importance of ensuring that ratings on US securities are fully recognised for regulatory purposes in the EU. Considering the stringent rules of the Dodd-Frank Act in respect of rating agencies, any other conclusion would seem illogical to the EBF.

We thank you for your consideration of these remarks. For your information, please find attached the letters we sent in November to the European Commission, as well as the Commission's reply. We note that the views expressed in our letter were shared by, among others, the European Fund and Asset Management Association (EFAMA).

Yours sincerely,



Guido RAVOET

Enclosures:

- EBF letter 0393-2010
- EBF letter 0394-2010
- EBF document D2120A-2010

EBF ref. 0393

Email

European Commission
Ms Maria Velentza
Head of Unit G3 - Securities markets
Maria.Velentza@ec.europa.eu

Brussels, 02 November 2010

Subject: ***Endorsement process under the EU Credit Rating Agencies Regulation***

Dear Ms Velentza,

The European Banking Federation would like to bring to your attention a concern regarding the interpretation of Regulation (EC) No 1060/2009 and specifically, the process for credit rating agencies to 'endorse' ratings issued in a third country pursuant to Article 4(3) of this Regulation.

Article 4(3) allows rating agencies established in the EU to endorse ratings issued outside the EU under certain circumstances. Specifically, it requests that:

'(b) the credit rating agency has verified and is able to demonstrate on an ongoing basis to the competent authority of the home Member State that the conduct of credit rating agencies by the third-country credit rating agency resulting in the issuing of the credit rating to be endorsed fulfils requirements which are at least as stringent as the requirements set out in Articles 6 to 12'.

In the understanding of the European banking industry, this endorsement process was created in order to ensure that the ratings produced by the largest rating agencies could continuously be used in the EU. It was a thoroughly considered solution to ensure the high quality of ratings in the EU while avoiding the duplication of ratings processes with the related risk of loss of analytical expertise.

However, from CESR's guidance on various aspects of the CRA Regulation dated 4 June 2010 (CESR document 10-347) we note that the Commission services have informally adopted an interpretation of Article 4(3) according to which endorsement would be permissible only if the regulation of credit rating agencies in the third country is as stringent

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as regulation in the EU, according to a judgment to be taken by the Committee of European Securities Regulators.

The EBF is **greatly concerned about this interpretation, which would blur the distinction between the endorsement and the equivalence regime**. While the latter explicitly refers to ‘legally binding rules’, this is not the case for the endorsement regime which rather refers to the conduct of the non-EU credit rating agency. **The EBF does not believe, therefore, that the Commission services’ informal interpretation of the endorsement process is supported by the wording of the Regulation**. Rather, this interpretation would stand in contrast to a carefully negotiated political compromise.

Furthermore, removing the flexibility of the endorsement process would **seriously impact on the capital adequacy of European banks and jeopardise financial market stability**. To date, CESR has identified only one country, namely Japan, as having equivalent regulation. Regulation in the United States is regarded as merely ‘broadly equivalent’ and it is thus not clear that ratings issued in the US may be used in the EU for regulatory purposes. It seems generally likely that only a few countries will pass CESR’s equivalence test by the date on which the Regulation becomes binding on ratings used for prudential purposes. This would have major negative implications for banks’ capital requirements and for the securitisation market in Europe.

- The inability to endorse the ratings for securities and securitised products issued and rated in third countries would place a significant strain on regulatory capital. For a AAA-rated product, for example, a risk weight of 1.250% would have to be used instead of 7%. For most portfolios, the rules governing securitisations in the banking book currently permit no alternative to external ratings. From 2011, moreover, a recognised credit rating will also be needed to determine capital requirements for securitisation positions in the trading book.
- Bearing in mind that the European Union and the Basel Committee have already proposed other measures to tighten the regulation of securitisation positions, the inability to use ratings issued in third countries for prudential purposes would generate further pressure to sell securitisation positions, but also other products issued and rated outside the EU. Collective selling can be expected to significantly drive down market prices, with knock-on effects on banks’ capital resources and the valuation of other market participants’ portfolios.
- A narrow interpretation of endorsement will drive a regulatory wedge between markets in the US, Europe and other financial centres.

The recognition of credit ratings issued in the US is particularly important to banks’ regulatory capital positions and to the European financial market. Given that the enactment of the Dodd-Frank Act has made the regulation of credit rating agencies in the US more stringent than ever, European banks can see no logic in disallowing the use of US ratings in Europe. Also in view of the fragility of the current financial market situation, this should be avoided at all costs.

The EBF understands that in the current discussions to amend the CRA Regulation, some Member States have put forward proposals to clarify the current legal text in respect of the endorsement process. In view of these dangerous implications of undermining the endorsement process, the EBF **calls on the European Commission to support these proposals which would confirm the initial intention of the two-pillared approach of endorsement and equivalence processes for the use of ratings issued outside the EU.** The already fragile financial markets must not be put to the test of the massive withdrawal of ratings in June 2011.

Please be aware that we have taken the liberty of sending a similar letter to your colleague Mario Nava, Head of the Banking and Financial Conglomerates Unit, and have also shared this concern with the Belgian Council Presidency. We look forward to learning about the Commission's next steps in respect of these concerns and remain at your disposal to discuss these issues personally.

Yours sincerely,



Guido RAVOET

Cc:

Michael Fridrich, Securities Officer - michael.fridrich@ec.europa.eu

EBF ref. 0394

Email

European Commission
Mr Mario Nava
Head of Unit H1 – Banking and financial conglomerates
Mario.Nava@ec.europa.eu

Brussels, 02 November 2010

Subject: ***Endorsement process under the EU Credit Rating Agencies Regulation***

Dear Mr Nava,

The European Banking Federation would like to bring to your attention a concern regarding the interpretation of Regulation (EC) No 1060/2009 and specifically, the process for credit rating agencies to ‘endorse’ ratings issued in a third country pursuant to Article 4(3) of this Regulation.

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Please be aware that we are sending a similar letter to your colleague Maria Velentza, Head of the Securities Markets Unit, and have also shared this concern with the Belgian Council Presidency. We look forward to learning about the Commission's next steps in respect of these concerns and remain at your disposal to discuss these issues personally.

Yours sincerely,



Guido RAVOET



EUROPEAN COMMISSION

Directorate General Internal Market and Services

FINANCIAL SERVICES POLICY AND FINANCIAL MARKETS
Securities markets

Brussels, 16. 11. 2010
MARKT/G3/MFR/an Ares (2010)

Mr Guido Ravoet
Secretary General
European Banking Federation
(EBF)
10 rue Montoyer
B – 1000 Brussels
Email: g.ravoet@ebf-fbe.eu

Subject: EBF ref. 0393 - Endorsement process under the EU Credit Rating Agencies Regulation

Dear Mr. Ravoet, *Dear Guido,*

Thank you very much for your letter of 2 November in which you raise concerns regarding the interpretation of Article 4 (3) of Regulation (EC) No 1060/2009 of 16 September 2009 (CRA Regulation) which sets out conditions for the endorsement of third country ratings by EU registered credit rating agencies.

According to Article 4 (3) b of the CRA Regulation a EU registered CRA may only endorse credit ratings issued by a third country CRA if it can demonstrate that the conduct of the third country CRA fulfils *requirements* which are at least as stringent as the ones set out in the CRA Regulation. This provision requires that (enforceable) requirements as stringent as those in the CRA Regulation have been established in the legal/regulatory regime of the third country. By contrast it would not be enough that a third country credit rating agency complies on a voluntary basis (using a code of conduct) with such requirements. Allowing the endorsement from ratings issued by credit rating agencies located in third countries where there is only a weak regulatory regime in place would raise concerns as to the enforceability of the high standards set by the CRA Regulation.

This interpretation is supported by the wording and rationale of the CRA Regulation and reflects the compromise that has been reached between the Council and the European Parliament during the negotiations of the original CRA Regulation in 2009. It further does not blur the distinction between the endorsement and the certification regime (Article 5 of the CRA Regulation). The certification regime is only open for smaller credit rating agencies whose activities are not of systemic importance to the financial stability or integrity of European financial markets. In addition, endorsement does not require a formal equivalence decision by the European Commission on the relevant third country.

This interpretation has also been endorsed by the Committee of European Securities Regulators (CESR) and is included in a CESR guidance which was published in June 2010¹. National competent authorities follow this guidance in the ongoing registration process for credit rating agencies. Reopening the discussion on the interpretation of the endorsement regime now would create legal uncertainty in the registration process. A review of Article 4 (3) at this stage is not justified given that no new evidence on the effects of Article 4 (3) b has been provided so far and therefore it would have as only effect to to significantly delay the adoption of this amendment which has been proposed by the Commission to grant the European Securities and Markets Authority (ESMA) supervisory powers over CRAs.

As you know many important third country jurisdictions (including Japan, US, Hong Kong) have recently enhanced their regulatory regime aiming at establishing a regulatory regime for CRAs that is equivalent to the CRA Regulation. As you rightly mentioned CESR concluded in its advice to the European Commission of May 2010 that, overall, the US legal and supervisory framework is broadly equivalent to the EU regulatory regime². Since then, the US regulatory regime for CRAs has been further enhanced by the Dodd-Frank Act and CESR and the Commission services are currently assessing to what extent the amendments have bridged the few remaining gaps between the EU and the US regulatory framework. Depending on the outcome of this assessment the Commission may propose an equivalence decision before the end of the transition period (i.e. 7 June 2011).

In addition, it should also be possible for EU registered credit rating agencies to assume the rating responsibility with regard to third country financial instruments so that the ratings could be used for regulatory purposes even if the country where the issuer is located does not have a regulatory framework which is as stringent as the CRA Regulation.

I hope these explanations are useful to you.



Maria Velentza
Head of Unit G3 "Securities markets"

Yours sincerely,



Mario Nava
Head of Unit H1 "Banking and
financial conglomerates"

¹ CESR's Guidance on Registration Process, Functioning of Colleges, Mediation Protocol, Information set out in Annex II, Information set for the application for Certification and for the assessment of CRAs systemic importance of 4 June 2010, p. 20 ff, Ref.: CESR/10-347.

² Technical Advice to the European Commission on the Equivalence between the US Regulatory and supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies of 21 May 2010. Ref.: CESR/10-332.