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## Comments of the EAPB on the ESMA consultation paper on CRA3 implementation

The European Association of Public Banks, EAPB, welcomes the opportunity to participate in the ESMA consultation paper (the CP) concerning the CRA3 implementation (ESMA/2014/150).

### Structured finance instruments (Annex I)

#### General remarks

We particularly welcome ESMA's understanding that bonds linked to quotes of an index or a benchmark do not fall under the definition of structured finance instruments (SFI) as stated in paragraph 24 of the CP (feedback statement, page 11).

Having said that, we would like to point out that it should be made clear that **Article 8b of the CRA Regulation** will only be applied to SFI which have a rating and which are accessible for public – retail and institutional – investors. In addition, Article 8b should be limited to SFI which are covered by the Prospectus Directive and the Transparency Directive. Moreover, Article 8b does not apply in respect of private or unlisted transactions. This means that certain SFI categories for other purposes (such as asset-backed commercial paper, ABCP) should not be a relevant category for the purposes of Article 8b in general. With regard to the fact that **Article 5 second sentence of Annex I of the CP** provides for the possibility to amend the delegated Regulation in order to add disclosure requirements for new types of SFI (escape clause), it should be clarified that none of the abovementioned SFI categories or bonds linked to quotes of an index or a benchmark will be added to the delegated Regulation at a later point in time.

Furthermore, ESMA states that some of the reporting templates are based on templates used by the Bank of England. It should be ascertained that non-UK market participants will be able to adjust to such templates. Additionally, **Article 8 of Annex I of the CP** should provide for a phase-in of the reporting obligation which will allow market participants to prepare the relevant IT systems. There should be a minimum phase-in period of one year.

## **Fees charged by CRAs to their clients (Annex III)**

**Q1+2.** The current market structure opens the opportunity for CRAs to exploit their market power in price negotiations. The CRAs often argue that their internal costs have increased because of more stringent regulatory requirements. For many years, CRAs have enjoyed very high margins. In the past few years, for instance, both S&P Ratings and Moody's Investors Service have reported a profit margin from operations of more than 40 percent. We do not see the link between fees and costs in such increases and would welcome a pricing policy which is geared more towards the CRAs' costs and provides deeper insight into cost structures.

With the templates as currently suggested in Annex III, ESMA will not receive information on the different components of the fee schedules of CRAs. Total costs charged to single clients of CRAs will also not give an insight. Since the beginning of the financial crisis, for example, issues of financial instruments have decreased significantly in some areas. However, due to price increases of CRAs, the total amounts of fees paid to CRAs by single customers may not have decreased significantly because of price increases for single services.

In order to gain insights into the fee structures of CRAs, the reporting of pricing should include a breakdown of pricing policies, the costs on which they are based and all changes of the policies that occur. Regular disclosure of the fee structures of CRAs can create transparency with regard to the fee structure. In the past, the structure of the fee schedules used by a CRA was not comparable to the previous years' structure. Therefore, a breakdown of details of fees for separate types of issuances would be useful. Also, new fee elements of each type of fee which were not part of the previous fee schedule should be presented as well as fee details should be made comparable to the previous years' fee structure.

So far, CRAs make it impossible to compare the total fees with the previous years' total fees simply by changing the thresholds and the quotients used to calculate the fees in accordance with issue volumes. In view of the short duration of rating agreements, this practice has enabled the CRAs to implement significant increases in their fees on a regular basis, and it was not clear for market players in what way these fee increases were related to increases in the CRAs' costs. For this reason the underlying scale of fees and charges should be reviewed, and an increase in the absolute level of fees for the same service should be made transparent. The fees charged by CRAs should be comprehensible for their clients.

AS the CRA Regulation states, fees should be cost-based. In this context, ESMA should ensure that CRAs will not transfer costs between different (international) offices or companies. At the same time, care should be taken not to create market entry barriers for new CRAs. At the beginning of a new CRA's activities in the market, its costs (especially sunk costs) may be particularly high. If these costs are not passed on to clients, this does not pose



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a problem, providing that all clients are treated in a comparable manner. In the case of variable price components, e.g. when the level of fees is coupled to the issue volume, it should be borne in mind that there are economies of scale because the underlying analytical effort is independent of the issue volume.

Should you have additional questions or comments, please do not hesitate to contact us.

Kind regards,

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*The European Association of Public Banks (EAPB) represents the interests of public banks, funding agencies and associations of public banks throughout Europe, which together represent some 100 public financial institutions. The latter have a combined balance sheet total of about EUR 3,500 billion and represent about 190,000 employees, i.e. covering a European market share of approximately 15%.*