German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

ESMA Consultation Paper 2014/150 on CRA3 Implementation

Register of Interest Representatives
Identification number in the register: 52646912360-95

Contact:
Daniel Selle
Telephone: +49 30 2021- 1611
Telefax: +49 30 2021- 191600
E-Mail: d.selle@bvr.de

Cornelius H. Neuring
Telephone: +49 30 2021- 1609
Telefax: +49 30 2021- 191600
E-Mail: c.neuring@bvr.de

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,000 banks.

Coordinator:
National Association of German Cooperative Banks
Schellingstraße 4 | 10785 Berlin | Germany
Telephone: +49 30 2021-0
Telefax: +49 30 2021-1900
www.die-deutsche-kreditwirtschaft.de

GBIC Comments on ESMA Consultation Paper 2014/150 on CRA3 Implementation

The German Banking Industry Committee (GBIC) would like to thank ESMA for the opportunity to comment on the Consultation Paper on CRA3 implementation. In the following, we would like to draw your attention on certain aspects of our comments on the ESMA Discussion Paper on CRA3 implementation (submission date October 10th 2013) that are of high importance concerning the Regulatory Technical Standards drafted.

Structured Finance Instruments (Annex I)
As an introductory remark, we want to point out that the tightened disclosure requirements cause difficulties that from our point of view cannot be justified solely by the aim of investor protection. As a result of the financial crisis and the turmoil in the market, investors in the securitization market have become much more cautious. Investors will not consider institutions that do only share fragmentary or misleading information. It should be kept in mind, that public availability of specific information could deter originators from the securitization market since details of their receivables management policy could become publicly traceable. Therefore, the more stringent disclosure requirements should be subject to critical examination.

We strongly agree with the exemption of bonds linked to quotes of an index or a benchmark from the definition of structured finance instruments (SFIs) as stated in No. 24 of the Consultation Paper (page 11). It should be made clear, however, that Article 8b will only apply to SFIs which have an external rating and which are accessible for public investors (both retail and institutional investors). In addition, we recommend that Article 8b should be limited to SFIs which are covered by the Prospectus Directive and the Transparency Directive. Moreover, we consider that Article 8b does not apply in respect of, among other things, private or unlisted transactions and securitizations that are not rated externally. This means in effect 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. In the context of term and replenishment ABS as well as ABCP programs for the real economy (securitization of trade receivables, autoloans and leases), we are especially concerned about the possible requirement to publish transaction-specific contracts. This would highly affect legitimate concerns of the (corporate) originators since these contracts are specifically tailored to the originators and contain highly sensitive information which probably disclose their receivables management strategy to competitors or customers. In such transactions, the disclosure requirements of Article 4 RTS would lead to a default of confidentiality usually agreed between the buyer and originator or sponsor. Moreover, the tightening of disclosure obligations, however, does not improve investors' position. For example, ABCP Investors already obtain directly – and confidentially – the information needed to make an informed investment decision. Furthermore, in fully supported ABCP programs CRAs base their examinations exclusively on the full risk-coverage of the sponsoring bank and usually receive no information on portfolio performance. The scope should therefore be limited to the extent that only those securitizations are included in which investors actually benefit from additional disclosure requirements. If disclosure requirements will be imposed on ABCP despite these arguments – the respective data must be based on an aggregated, non-customer-related level. Possible documents could be the monthly investor reports or the information memorandum.

Art. 5 second sentence Annex I of the Consultation Paper, provides for the possibility to amend the regulation in order to additional disclosure requirements for new types of structured finance instruments. It should be made clear, that none of the abovementioned SFI categories or bonds linked to quotes of an index or a benchmark will be added to the regulation at a later point in time.

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In the ESMA hearing on March 14, 2014 was mentioned, that some of the reporting templates are based not on the ECB reporting templates but on templates used by the Bank of England. It should be made sure, that non-UK market participants will be able to adjust to the templates used in the UK. Additionally, Art. 8 of Annex I 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.

Finally, we have some functional remarks in terms of data to be delivered according to the templates pursuant to article 5. ESMA should use the EDW of the ECB as far as possible to avoid double-reporting and to ensure consistency of the data. Accordingly, data requirements of ESMA referring to data required by the ECB as well should be the same. This should include also for example the use of ND options for non-available data and the date field lengths.

European Rating Platform (ERP, Annex II)
We welcome the development of a rating platform which will also provide easy access to less regular users. We support the efforts being made to enforce higher quality standards for ratings in order to increase the transparency and comparability of the ratings and to enhance their methodology. We would prefer that information is published according to option C of the ESMA discussion paper (all data reported until midnight will be published in one shot the next day at 11 am). This would give CRAs enough time to fix any technical or content errors.

Rating agencies publish their reports often in the (late) evening. With the proposed model in Article 9 of Annex II, any document issued in the late evening would not be reported on the ERP until 20:59:59 UTC the following day. In case of the ratings reported on a Friday, it would be sufficient that the data will be published at 11 am on the next working day (Monday). Exemptions should be made for bank holidays (which are different in different countries).

To improve the information services, interested parties should be able to subscribe to E-Mail alerts on the ERP website to draw attention to specific rating actions (e.g. downgrading of an issuer) and to provide market participants in due course with important information. Easy access to the content of the ERP website via mobile device could be very useful.

Fees Charged by CRAs to their clients (Annex III)
The current market structure opens the opportunity for rating agencies to exploit their market power in price negotiations. The agencies often argue that their internal costs have increased because of more stringent regulatory requirements. For many years, the agencies 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 (see McGraw Hill 2013 Annual Report, Segment Reporting, p. 59, and Moody's 2013 Annual Report, p. 38). We do not see the link between fees and costs in such increases. Finally it is a result of the oligopolistic position of these CRAs. We would therefore welcome a pricing policy which is geared more towards the agencies' 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 rating agencies. Total costs charged to single clients of rating agencies 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

rating agencies, the total amounts of fees paid to rating agencies 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 rating agencies, the reporting of pricing should include a breakdown of pricing policies and the costs on which they are based. Regular disclosure of the fee structures of rating agencies can create transparency with regard to the fee structure. Thus, we suggest amending the proposed Article 8 Section 2 of the RTS to the effect that not only material changes in pricing policies shall be reported, but all changes in pricing policies. In the past, the structure of the fee schedules used by a rating agency was not comparable to the previous year's structure. Table 1 of Annex I of the proposed RTS (Fields 8 to 11) should include a breakdown of details of fees e.g. for separate types of issuances. Additionally, fields should be introduced to show new fee elements of each type of fee which were not part of the previous fee schedule. Fee details should be presented in a way to make them comparable to the presentation of previous years. In the past changing of thresholds and quotients used to calculate the fees in accordance with issue volumes, led to the effect that total fees were no longer comparable with those of the previous year. In view of the short duration of rating agreements, this practice has enabled the agencies 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 agencies' 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 rating agencies should be comprehensible for their clients.

We believe that fees should be cost-based as set forth in CRA3 Annex I Section B 3c. In this context, ESMA should ensure that rating agencies will not transfer costs between different (international) offices or companies. By applying a transfer pricing system, as is common in a corporate environment, the cost basis of fees could be determined. At the same time, care should be taken not to create market entry barriers for new agencies. At the beginning of a new rating agency'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 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.

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