

March 31st, 2011

Public consultation by ESMA on the application of the endorsement regime under article 4(3) of the Credit Rating Regulation 1060/2009

1. The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, *i.e.* more than 350 commercial, cooperative and mutual banks. FBF member banks have more than 25,500 permanent branches in France. They employ 500,000 people in France and around the world, and service 48 million customers.

2. Since the beginning of the financial crisis, as issuers as well as intermediaries, French banks have supported the implementation of an appropriate regulation on credit rating agencies in the light of the evidence of market failures in the field of some structured products and of securitised products based on heterogeneous US mortgage credit portfolios.

Thus the FBF has strongly supported the implementation of Regulation n°1060/2009 on Credit rating agencies which appropriately addresses, for instance, the necessary distinction between the rating of Issuer's debt instruments (Corporate bonds, Government bonds) and the rating of structured debt instruments (Securitisation vehicles: ABS, CDO ...).

3. The FBF welcomes the opportunity to comment on the ESMA's consultation paper on the application of the endorsement regime.

4. FBF's response to this consultation paper is based on the following views, already expressed to the Commission in a more general context :

- Credit rating agencies should not be the scapegoats of the financial crisis. If there was an evidence of market failure in the field of very complex securitised products based on US mortgage credit portfolios, the responsibility must be shared with the US shadow banking system and with the lack of adequate action by US regulators concerning the origination and the selling practices of these products. There was only little evidence of market failure on other market segments.
- In the field of securitisation, French banks therefore consider that the key stone for an adequate regulatory framework is the mutual recognition between European Union and US based on equivalence of regulations.

5. Concerning the endorsement regime, the FBF would like to express some concerns as regards the prudential impact of the proposed regime and the calendar of its implementation:

- Ratings published by credit rating agencies, based in the EU or elsewhere, are necessary for issuers - for governments as far as for corporate issuers or banking issuers (for ordinary funding as for structured debt products) - , for lenders and for investors. Therefore, if the FBF strongly supports the application of consistent regulations applicable to credit rating agencies across the world (and especially in G20 jurisdictions), ***the use in the European Union of ratings released by third country rating agencies is of prominent importance and the impossibility to use such ratings from the 7th of June 2011 would lead to major additional capital requirements for banks which would, for a large part, unfounded.***
- As a consequence, while the FBF does not challenge ESMA's legal analysis, it draws the attention of financial markets regulators to the fact that the implementation of the proposed regime on the 7th of June 2011 is not realistic since it requires cooperation agreements between supervisors and the readiness of ESMA and the Commission to implement them immediately.

Indeed, the combination of paragraphs 23, 26 and 27 of the Annex I of the consultation paper leads to the following conclusions:

- before the 7th of June, self-imposed basic rules are enough if there is no equivalent local regulatory regime for non EU CRAs;
- after the 7th of June, the ability to endorse ratings issued by non EU CRAs requires exchange of information (between supervisors) in application of cooperation agreements..

As those conditions seem impossible to meet within the short remaining time span, the enforcement of the new regime on that date would result in major prudential impact for the banks holding such securities. This would be unreasonable and ***the application of the proposed regime should be postponed. The FBF considers that, in order to allow supervisors to sign and implement cooperation agreements, one and a half year is necessary and proposes that the transitional period ends is renewed until the 31st of December 2012 and at least that a grandfathering clause for the stock of already rated instruments.***

6. The FBF shares the European Banking Federation's views as regards ESMA's impact assessment and is skeptical about the accuracy of this impact assessment, notably in view of the following considerations, included in EBF's response:

"While recognising the difficulty of obtaining meaningful data, the Impact Assessment is almost void of any data to support ESMA's qualitative considerations. Even for the most fundamental aspects of the analysis such as what would be considered to constitute "high" or "low" costs, there is no specification of ESMA's classification.

- *It is similarly not clear on what basis ESMA has designed its weighting system and the summary, comparing costs and benefits across the different concerned groups.*
- *The EBF is furthermore sceptical about the relevance of some of ESMA's qualitative considerations. Notably the assumed costs and benefits of the endorsement regime as interpreted by ESMA should be compared with those that would be applicable under the alternative assumption that it was in the responsibility of the rating agencies themselves to ensure that the stringent criteria of the EU CRA Regulation were*

applied to ratings issued from outside the EU. Instead, ESMA's comparison seems to assume that non-EU ratings would alternatively be subject to no qualitative controls at all.

- The EBF is also struck by ESMA's apparent assumption that third countries could or should be assumed to adapt their own legislation to the rules applied in the EU (e.g. in respect of point 46 of ESMA's CP, "(t)he functioning of the endorsement mechanism as set out in CESR's Guidance may require changes to the national legislations in certain third countries. In some circumstances, these changes may not be feasible or rapid enough to meet the timeline defined by the Regulation." The EU rules on rating agencies go significantly beyond the agreement reached in the International Organization of Securities Commissions (IOSCO) on the rules applied by the EU to rating agencies, meaning that there is no reason to assume they would copied in this form by other jurisdictions.
- In addition, the EBF notes that ESMA seems to disregard the new provisions of the Basel III framework for the "Incorporation of IOSCO's Code of Conduct Fundamentals for Credit Rating Agencies"¹. On the External Credit Assessment Institution (ECAI)'s recognition process, Basel III requires the following: "National supervisors are responsible for determining on a continuous basis whether an external credit assessment institution (ECAI) meets the criteria listed in the paragraph below. National supervisors should refer to the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies when determining ECAI eligibility. The assessments of ECAs may be recognised on a limited basis, e.g. by type of claims or by jurisdiction. The supervisory process for recognising ECAs should be made public to avoid unnecessary barriers to entry."
- Questionable is also the assumption, in point 52 of the CP, that "the agencies could adjust their processes and organization in the medium/ long term in order to recover the supply of [ratings issued outside the EU] in the Community". Rather, this would require either a relocation of analysts, likely further away from the rated entities; or the appointment of new analysts with an associated loss of expertise. European banks do not believe that either approach would be conducive to the quality of the ratings."

Therefore, the FBF is of the opinion that a second and global impact assessment on the prudential impact of the implementation of the proposed endorsement regime must be made in liaison with the EBA, in order to assess the potential additional capital requirements.

¹ Basel Committee on Banking Supervision – "Basel III: A global regulatory framework for more resilient banks and banking systems", December 2010, p.52.