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BBVA Response to ESMA Consultation Paper on the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Regulation 1060/2009

BBVA welcomes the overreaching objective of improving transparency, competition and the quality of credit rating agencies (CRAs) as they have been a main source of distress during the current crisis. In that vein, we support measures aimed at requiring registration, encouraging competition, avoiding conflict of interest or offering higher disclosure of methodologies to improve instruments valuations. Nevertheless, there is still huge room for manoeuvre to promote theses goals as the current regulation does not necessarily address these purposes sufficiently.

We are concerned about ESMA's interpretation on Article 4.3 as it is too stringent. Such an understanding of the quality of CRAs would spill over the banking system by increasing the regulatory capital requirements burden which would jeopardise the industry capacity of giving new credit. Therefore it could dampen the economic recovery.

Moreover, we consider inconsistent the differentiation in the use of ratings at CRA subsidiaries level. For this reason, we do not share ESMA's interpretation, where only ratings issued in Europe or Japan could be available for regulatory purposes, but not the ones issued by third countries, which would create regulatory uncertainty for firms. For us, it makes more sense that if a CRA issuing a rating belongs to the same company it will have the same corporate methodologies and control systems regardless where it is established. Therefore, the ratings of

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different affiliates belonging to the same group should be equally treated for regulatory purposes provided they share common corporate strategies.

In our opinion, the endorsement process should be flexible enough to allow CRA proving that the performance of the credit rating activities in third - world countries (i.e. methodologies, procedures and control systems) is similar those developed in EU and Japan. In addition, we favor an extension of the tight deadline granted by the ESMA, as CRAs may not be able to put in place the necessary arrangements before next June.

There is a need to highlight the risk of an increase in capital requirements in financial institutions (not only for the small ones, but also the biggest) as a consequence of the possible non-acceptance of some third-country ratings in the EU ensued from ESMA's interpretation. This increase in the regulatory capital requirements will also affect capital costs and institutions profitability, which could be transformed to consumers and economy's real growth.

Another source of concern is the intention of some CRAs to change their methodologies in order to improve their public reputation. These CRAs, which still act under a oligopoly market structure, are planning to introduce methodological changes which may exacerbate volatility in the markets and are difficult to justify as they do not take into account the benefits of geographical diversification.

Regarding ESMA's impact assessment, we consider it is totally biased. It is unreasonable that the majority of the costs to improve CRA legislation lies in financial institutions (70% for financial institutions, whereas only 25% will impact on CRAs, and 5% on regulators). This could create negative distortions in competitiveness and in markets. This costs and benefits analysis presented by ESMA, is biased and mostly targeted on the financial industry while it should target mainly the CRAs which is the problem here to be addressed. Thus, we recommend its elimination. Moreover, we disagree with the ESMA impact assessment conclusion. In our opinion, this

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regime delivers such high costs in the low/medium term for banks and market efficiency, that they will never be offset by future benefits.