

Association for Financial Markets in Europe International Capital Market Association

Response by AFME and ICMA to CESR's Consultation on Guidance on Registration Process, Functioning of Colleges, Mediation Protocol, Information set out in Annex II, Information set for the application of Certification and for the assessment of CRAs' systematic importance.

30th November 2009

Overview

We comment on CESR's proposals from the perspective of investment firms making use of credit ratings for regulatory purposes. Accordingly we do not answer all of CESR's questions.

There are three main issues which we think it crucial for CESR to take into account as fully as possible in developing its Guidance, so as to limit the potential disruption to market stability that could arise from: regional fragmentation in the use of ratings; significant impact on firms' capital requirements; and/or legal and practical uncertainty:

- (i) Effective and streamlined decision making by all CESR members, both among themselves and with members of CEBS responsible for ECAI assessment, is vital. Market participants need CESR members to maintain the workability of current arrangements, and to work towards the promulgation of consistent judgements.
- (ii) The endorsement regime needs to be deployed in a way that enables firms to maintain existing use of third country ratings without unnecessary disruption to regulatory capital, and without putting markets and liquidity provision under undue stress.
- (iii) Given that the Regulation was carefully drafted to provide for well-controlled use of worldwide ratings without significant and unnecessary disruption to their regulatory use, it is vital not to seek to apply gold-plating interpretations, for example relating to endorsement, that are not consistent with the legislative text.

Section II: Guidance on the Registration Procedure

2A. Application for registration: Structure for applications from CRA groups

Q2: Do you agree with this approach? If not, please state your reasons.

CESR states that "each home competent authority will adopt its own separate decision on the registration of the member of the group for which it is the home competent authority". Bearing in mind that CRA groups' ratings are not attributed to a particular member of the group, and that they apply worldwide, in order to avoid the confusion that could result in the regulatory use of ratings if some subsidiaries of a CRA were registered and some were not, competent authorities should strive to reach

consistent decisions on registration across the EEA. The members of a group which are covered by a registration should in any event be disclosed, so that firms know which entities' ratings they can use, and which not. In addition to the global CRA, this will be relevant in the case of ratings issued by joint ventures or affiliates – where ratings may not be issued in the global CRA's name.

6. Notification of the decision on the registration, refusal of registration or the withdrawal of registration of a credit rating agency

Q13: Should CESR issue guidance about the transparency of the registration procedure? If yes, please provide your views on the following issues:

- 1) Should the competent authority of the home Member State publish the decision on the registration, refusal of registration requested by existing CRAs or withdrawal of registration? If yes, what information should be published?*
- 2) What information should contain the notification by the competent authority to the Commission, CESR, other competent authorities and the applicant (i.e. regarding the description of opinions of any dissenting authorities) of any decision under Article 16, 17, or 20?*

Firms need to know immediately about any decisions by competent authorities about registration or withdrawal of registration that affects their ability to make use of a CRA's ratings for regulatory purposes. We particularly agree with CESR's statement in paragraph 59 that firms need to know about refusal decisions. We agree under paragraph 60 that it is a concern that the 10 day grace period may have expired before the list of registered CRAs is updated. Under paragraph 58 how long it will take for decisions on CRAs to be published in the OJ and CESR website? The market needs full regulatory transparency once a CRA is subject to a likely refusal or withdrawal of ECAI status (or a CRAs' withdrawal of a rating), and before the final decision is made, so that there is time for firms to make alternative arrangements, whether by using a different CRA's ratings, or capital planning involving unwinding affected positions, in an orderly and organised way before the end of the grace period. It is of paramount importance that all information be made available to the market on an even-handed basis, in order to avoid selective disclosure of potentially material non-public and price-sensitive information.

Section III: Guidance on the procedure for endorsement

We stress the importance, from both a regulatory and a market perspective, of ensuring that the endorsement process is enacted smoothly, so that authorised firms are not unnecessarily prevented from making continued regulatory use of ratings provided by third country CRAs. In particular, in order to avoid severe disruption to firms' existing use for regulatory purposes of ECAI ratings, it will be essential, where relevant, to enable registered CRAs to endorse existing ratings by ECAIs to enable that use to continue seamlessly.

We understand that some of CESR's proposals are based on an interpretation under which a finding of equivalence of the relevant third country standards should be a necessary condition to enable a CRA to endorse a rating originating in that country. We do not think that such a restriction is provided for in the Regulation. Indeed, we consider that such an interpretation would be inconsistent with the legislative text.

Article 4.3(b) of the Regulation clearly states that it is the conduct of credit rating activity by the CRA that must fulfil requirements that are at least as stringent as those in Articles 6 to 12. The only requirements in Article 4 that relate to the third country regulatory environment itself are Article 4.3(f), (g), and (h) (applying from 7th June 2011), none of which foresees or requires an equivalence regime: indeed, Article 4.3(f) merely requires that the third country CRA is authorised or registered and subject to supervision in the third country. Imposing an equivalence condition on endorsement would therefore be an unjustified and inappropriate gold-plating of the Regulation.

We are concerned that the timetable is already very tight for the registration and endorsement process. Any unnecessary inability to use ECAI ratings will cause an additional increase in capital requirements, with a consequent risk of further destabilisation of market conditions. Arbitrarily imposing an equivalence condition on endorsement, over and above the conditions provided for in the Regulation, a mere six months after the introduction of the endorsement regime, would add further and unnecessarily to the risk of market destabilisation, especially given the lead times on making equivalence determinations and the evolving state of regulation of CRAs across the globe.

1. CA Procedures for endorsement

Q15: Do you agree with this approach? If not, please state your reasons.

Under paragraph 67, it is vital that the approval or not of endorsement is disclosed to the market as well as to the applicant.

2. CRA procedures for endorsement

Q16: Do you agree with this approach? If not, please state your reasons.

We agree with CESR that it is not practical or necessary for the authorities to check beforehand every rating that is endorsed, and that approval for the possibility of endorsement of ratings of a non-EEA CRA should be a once-only decision, and that it should apply to all endorsed ratings issued by that non-EEA CRA. Individual review of ratings would impose a significant burden for firms, and make it disproportionately difficult to make use of ratings for regulatory purposes.

3 (Q17). Registration without the conditions for endorsement being met

Q17: Do you agree with this approach? If not, please state your reasons

Firms need to know well before the Regulation takes effect whether relevant ratings that they wish to use for regulatory purposes are endorsed or not. It is important to ensure that the timetable for implementation of the Regulation takes this need into account.

4. Transparency regarding the third-country CRAs whose ratings may be endorsed by EU CRAs

Q18: Do you think that authorities and/or CESR should publish the list of third-country CRAs whose ratings a registered CRA is authorised to endorse?

We do not agree with the view, which we understand some are taking, that it is necessary for there to be an equivalence determination for a registered CRA to be able to endorse ratings for a third country. Where a CRA can demonstrate that it has applied controls and procedures that meet the requirements of the regulation, it should be able to endorse the ratings. However, where a third country has been deemed equivalent, that fact should be sufficient for the CRA to demonstrate that it has met the conditions for endorsement. Whilst it is of some interest which ratings a registered CRA is authorised to endorse, what must most importantly be clear at all times is which ratings have actually been endorsed and are thus recognised in accordance with the Regulation.

Section IV: Guidance on the procedure for certification

1. CA certification procedure.

Q19: Do you agree with this approach? If not, please state your reasons.

We agree that certification should apply for the entire EU.

4 Withdrawal of certification

Q22: Do you agree with this approach? If not, please state your reasons.

A grace period is needed for withdrawal of certification as for withdrawal of registration, to enable firms to find replacements for any instruments whose ratings are no longer certified. The market needs full regulatory transparency once a CRA is subject to a likely sanction and before the final decision is made by the college, so that there is time for firms to make alternative arrangements, whether by using a different CRA's ratings, or capital planning involving unwinding affected positions, in an orderly and organised way before the end of the grace period.

5 Relationship between equivalence and endorsement

Q23: Do you agree that the quality requirements as regards credit ratings endorsed and credit ratings issued by a certified CRA should not be different, in order to achieve the same level of investor and consumer protection in both cases?

We agree that the regimes should not be different, and that the test should be equivalence, i.e. that they should achieve the same objective, even if the precise rules are not exactly the same.

Q24: Do you agree with this approach? If not, please state your reasons.

We agree that a third country equivalence decision should be sufficient on its own to demonstrate that the third-country CRA fulfils requirements that are at least as stringent as those set out in Articles 6 to 12 of the Regulation

Q25: Do you agree that the Article 4.3 (b) requires local legal and regulatory requirements as stringent as those in Articles 6 to 12 of the EU Regulation? If not please provide your reasoning.

It is quite possible for self-imposed requirements to be as stringent as those imposed by legislation or regulators. The criterion should be whether the rating process is subject to controls that meet the standard of the Regulation.

Q26: Do you agree that in the event there is a negative equivalence assessment by the Commission it is still possible to meet the conditions for endorsement set out in Article 4.3?

Yes. As noted under Q25, provided the rating process is subject to controls that meet the standard of the Regulation, this should be sufficient.

Section V: Guidance on the general and periodic disclosures and the transparency report

1, 2, 3 (Q27, Q28, Q29) Language of disclosures and transparency report; means of publication, timing of publication or submission

Clarity of disclosures and signposting so that they are easy to find will aid market discipline.

Section VI: Operational functioning of colleges

1. Selection of facilitator

Q30: Can you suggest any efficient methods, particularly by identifying some appropriate quantitative indicators, for assessing this criteria in a manner that allows differentiation between various member states?

Whilst users do not have a direct interest in the operation of CRAs' colleges, our comments on this area are made from the perspective of general principles of good management of supervisory colleges. The proposal to select a facilitator based on the workload distribution amongst CAs, and in particular that one CA should not be the facilitator for more than one of the three largest CRAs, appears arbitrary, and does not reflect practical needs from the users' perspective. The appropriate criteria for selecting the facilitator are specified in Article 29.5, of which 29.5(d) "administrative convenience, burden optimisation, and an appropriate distribution of the workload" is only one. The aim should be to achieve the best quality regulatory outcome, weighing all the factors. This should consider experience with and skill in overseeing capital markets activity and in supervision of cross-border firms. Where it is necessary, it should be up to the CA, selected according to objective criteria, to resource the facilitator function to meet the task.

Q31: Are there any other factors that should be considered in assessing which competent authority should be facilitator under the above criteria?

For efficiency, the decision should be closely coordinated with existing arrangements among CEBS members related to ECAI determinations.

3. Interaction with CEBS and CEIOPS

CESR proposes that CEBS should have a non-voting role in meetings of colleges. We welcome the recognition that the assessment of CRAs needs to be a cooperative effort between CESR and CEBS, and urge the importance of consistent decision-making between CESR's role and CEBS's role in designated CRAs as ECAIs.

4. Non-members participation in college activities

We agree that non-college members should not vote in college decisions.

5. Decision making

As noted above, we encourage consistent decision-making in relation to members of the same group.

5B. Withdrawal of registration

Q33: Is this an appropriate system for dealing with the withdrawal decision process? (the home competent authority makes the final decision to remove registration from a CRA, and there is an appeal mechanism for the CRA etc)

While CESR's proposals seem to be aimed at promoting as consistent decisions as possible on withdrawal of registration, it is not clear what the practical effect would be if different home supervisors disagree. It is important to minimise market destabilisation that might arise from poorly coordinated or long-drawn-out decision-making about withdrawals.

In paragraph 131 it is stated that the process "may" include a notification to the CRA. For this to be efficient and transparent it appears that "may" ought rather to be "shall".

5C Supervisory measures/sanctions

Q34: Is this an appropriate system for dealing with supervisory measures/sanctions?

In paragraph 135 it is stated that the process "may" include a notification to the CRA. For this to be efficient and transparent it appears that "may" ought rather to be "shall".

6. Location of issuance and impact on supervisory relationship

Q35: Which of the criteria should be used to identify the issuing office and why? (jurisdiction of listing of the rated issuer/assets; jurisdiction of the issuer's incorporation, jurisdiction where the employee leads the rating discussion with the issuer; or jurisdiction where the lead analyst is located)

Analysis and ratings decision-making can often occur across EU and global borders, depending on the complexity of the issuer, which means that the concept of a specific ‘office that issues the rating’ does not necessarily make sense. Furthermore, the relevant criteria to be used, e.g. taking into account the location of the lead analyst or the chairperson of the credit committee, should be articulated by the CRA as part of their registration process. Having been agreed they should be complied with consistently. Whatever the chosen criteria, to avoid uncertainty, the country of origin of a new rating should be fixed at issuance

Section VIII: Guidance on Annex II

2. General guidelines on the information to be submitted

Q38 Do respondents have any comments on the guidance as set out in the remainder of section VIII?

Q39: We would appreciate comments from market participants on the usefulness of adding the additional ECAI information requirements within this consultation paper

In the interests of facilitating speedy recognition of CRAs and consistency with the ECAI regime, we agree that it is useful to include ECAI requirements in the guidance.