

March 31st, 2011

*BNP Paribas Position note on the  
ESMA Consultation paper – “Guidelines on the application of the  
endorsement regime under Article 4(3) of the Credit Rating Regulation  
1060/2009*

BNP Paribas welcomes the opportunity to respond to ESMA's Consultation paper – “Guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Regulation 1060/2009”.

First, we would like to bring to your attention our significant concerns regarding the ESMA's legal analysis of the “endorsement” regime and more particularly with regard to the interpretation that this regime should rely on ‘at least as stringent as’ requirements to be established in **law or regulation** in the relevant third country jurisdictions.

We provide in the last part of our response our view on the ESMA's impact assessment.

### **1. Application of the Endorsement Regime as proposed by ESMA**

We fully support the G20's objective to strengthen the supervision of the Credit Rating Agency (CRA) in order to rely on adequate, accurate, timely risk assessments of counterparties or financial products. Therefore we welcome the provisions of the Basel III accord that requires the incorporation in the regulatory requirements of the IOSCO's Code of Conduct Fundamentals for Credit Rating Agencies and requests national supervisors to determine the CRA's eligibility on a continuous basis<sup>1</sup>.

We also support the requirements of the European regulation 1060/2009 on Credit Rating Agencies Regulation. The aim of the endorsement regime (art.4 (3) of the regulation) is to provide a mechanism to allow the continued use of the ratings issued by the non EU-CRA but subject to the EU registered CRA provided that the conduct of ratings activity in that third country had been carried out in accordance with the requirements which are at ‘least as stringent’ as those in the EU (art. 4 (3-b)).

We recall hereunder some of the other criteria for the endorsement set forth by the Regulation:

- the CRA established in the third country is authorized and registered, and subject to supervision, in that country (art. 4 (3-f)),

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<sup>1</sup> Basel Committee on Banking Supervision – « Basel III: A global regulatory framework for more resilient banks and banking systems », December 2010, paragraph 120, p.52

- the CRA that has endorsed a credit rating issued in a third country remains fully responsible for such a credit rating (art. 4 (5)).
- in addition, ratings outside the EU can only be endorsed if the EU competent authorities have the necessary co-operation agreements in place.

Indeed, as Basel III, the regulatory framework formalized in the CRA Regulation provides sound criteria for addressing reliance on external credit ratings.

In the consultation paper ESMA considers that the requirements for rules to be ‘as stringent as’ those of the EU CRA Regulation refer to rules that are established by law or regulation of the third countries and consequently ESMA is of the view of that these requirements cannot be applied on a ‘self-imposed basis’. Whilst we may consider the ESMA’s position as being debatable as it appears in various industry responses, our first concern refers to the practical implications of the endorsement application as of June 7<sup>th</sup>.

Once again, we would like to point out that the endorsement process might turn to be more complex than initially assessed due to the “leading analyst” criterion<sup>2</sup> and considering that it should be subject to the prior setting up of formal cooperation arrangements.

According to the point 23 of the consultation paper, “During the transitional period ending the 7<sup>th</sup> of June 2011, the endorsing CRA were required to confirm to the EU authorities that the third country CRA is meeting requirements at least “as stringent as” Articles 6 to 12 **on a self-imposed basis if there was no equivalent local regulatory regime.**” After the 7<sup>th</sup> of June 2011 the ability to endorse ratings will rely on:

- the exchange of information between supervision and coordination of the supervisory activities set forth by cooperation agreements between competent authorities, and
- the evaluation of the regulation of the third country by ESMA, without requesting as a necessary condition “an exact replication of all EU Regulation requirements” (point 27 of the consultation).

We would like to underscore that the effectiveness of the endorsement depends first and foremost on the establishment of the cooperation agreements that falls under the responsibility of the relevant EU authorities.

Therefore we urge ESMA to carefully consider the major negative implications arising from an implementation of the endorsement process prior to ESMA and the relevant EU authorities having had the time to complete their review of relevant rating agencies laws in non EU countries, and finalizing adhoc cooperation agreements laws.

**A phased in implementation (that in fact would reasonably extend the transition period during which the self-imposed basis equivalence applies)**

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<sup>2</sup> The rating agencies actual lead analyst coverage for a given country (or corporate or asset) may actually be located domestically or in a different country depending upon the rating agency’s lead analyst organization (hub and spoke organization versus domestic model).

**would prevent major unintended disruption which would result from hasty review of the endorsement that would arise for banks' capital requirements, for the management of the liquidity in Europe and for the securitization market in Europe.**

## **2. ESMA's impact assessment**

We consider that the negative short impacts have been seriously underestimated. Whilst we support the long term benefits of the regulation on CRA we consider that the regulation should promote an appropriate transition period towards the new endorsement requirement application, without putting an excessive, unjustified regulatory burden on credit institutions (through 'artificial-created' additional capital requirements).

In our previous response (BNP Paribas Position note – ESMA call for evidence on the criteria for endorsement (Art.21 (2) (a) of the draft amended CRA Regulation) as of January 24<sup>th</sup> 2011 we provided an in-depth analysis of the unintended regulatory imbalances of a hasty application of the endorsement that will be generated between markets in US, Europe and other financial centers (in short: significant rise in the banks' regulatory capital, sharp negative impact on securitization market that will generate fire sales, spiral downwards of the valuation of other market participants' portfolios, uneven level playing field between banks in the US, Europe and other financial centers).

## **3. Conclusion**

Therefore, in order to avoid a massive regulatory derecognition of ratings in June 2011 and its unjustified negative consequences for the financial markets' stability we urge once again ESMA to adopt a phased in approach whereby the CRA endorsement process would be fully operational only once ESMA and the relevant EU authorities have completed the extensive review of the Americas and Asia's CRA regulatory regimes and taken appropriate steps to set up the relevant cooperation agreements.

**We request for postponing the application of the endorsement regime and we propose that the transitional period ends on the 31<sup>st</sup> of December 2012.**

Given the importance of the issues as regards banks' capital adequacy requirements and the market disruption effects, regulatory imbalances that will be generated we are copying this to the European Banking Authority and European Commission.