FEDERATION
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20th JUNE 2011

ESMA CALLS FOR EVIDENCE ON THE ASSESSMENT OF COMPLIANCE OF CREDIT RATING AGENCIES WITH ARTICLE 8.3 OF THE CRA REGULATION (1060/2009/EC) AND ON RATINGS DATA PERIODIC REPORTING REQUIREMENT FOR CRAS ACCORDING TO ARTICLE 21 (3) (E) OF THE DRAFT AMENDED CRA REGULATION

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RESPONSE OF THE FRENCH BANKING FEDERATION (F.B.F)

GENERAL REMARKS

- The **French Banking Federation (FBF)** represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 500 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.

- The key role which is played by Credit Rating Agencies (CRA) in the economy is obvious for interest rates allowed to entities, for issuers (both legal entities and States) and by the way on the means to finance the economy. However, it’s also patent that during the last crisis they were involved in chain of elements which contributed to enhance the crunch as it has been demonstrated by the report Larosière.

- The French Banking Federation thanks the European Security Market Authority (ESMA) for giving him the opportunity to contribute to **the calls for evidence issued on the assessment of compliance of credit rating agencies with article 8.3 of the CRA Regulation (1060/2009) and on ratings data periodic reporting requirement for CRAs according to article 21 (3) (e) of the Draft amended CRA Regulation**.

- We would like to bring the attention of the ESMA on the fact that the FBF responses will be limited to section for all stakeholders of the calls. Even if, it goes without saying that answers to be provided by CRAs themselves are of main importance. Please, note also that the figures of the questions have been amended to be in accordance with that document.

I / ON THE ASSESSMENT OF COMPLIANCE OF CREDIT RATING AGENCIES WITH ARTICLE 8.3 OF THE CRA REGULATION (1060/2009) »

Q1. What do you consider to be the most important factors within a credit rating methodology to ensure that it is?
a. rigorous;
b. systematic;
c. continuous; and
d. subject to validation based on historical experience, including back-testing?

Please provide as much detail as possible, including reasons, and please list each factor by reference to each requirement.

The FBF shares the objective of the ESMA consisting to establish a credit rating methodology which will ensure a safe and sound financial system.

For that purpose and as we have noticed that most of time methodologies are available to the public but quantitative assumptions used (including stresses) are not, we consider that methods to be used shall not only be rigorous but also transparent regarding criteria and assumption grounding the rate position in a manner that investor and issuer shall be at any time able to understand the reason of the grade.

Furthermore, in our understanding, expressions rigorous, systematic, continuous and based on historical experience shall also mean that the methodology is based on consistent criteria on a global basis. A peer review exercise is critical to making ratings comparable within one country to another; Regional differences should be explained in writing (e.g. level of government support). As far as possible, changes in methodology must be applied to all issuers at the same time to avoid market distortion. Those changes can sometimes lead to the decision to withdraw a rating on particular debt instruments. This is unpredictable and particularly detrimental to investors and bank activities, while rating agencies are not accountable of their decision to withdraw ratings. Therefore consistency in rating methodologies is crucial. Periodicals reviews for all rated issuers and the analyst's rotation are recommended.

Q2.In relation to each of the factors identified in Q7, is there a factor that is not covered in the standards embodied in the CESR Guidance published on 30 August 2010? If so, please provide reasons as to why that factor should be included in the RTS.

As there are some linkages between the regulation being adopted around the world and particularly in Europe on financial system, the FBF wants to insist on the point that regulation of CRAs shall take into account and be consistent with texts such as CRD IV and Basel II/III Framework.

Each stakeholder knows that those texts will affect banks activities and possibly how the capital requirement could change the ratings. Consequently, discrepancies of assessment methods shall be avoid and be in accordance with the prudential rules to be applied by banks in order to ensure the trend of our economy system resilience.

Q3. Are there any factors covered in the standards embodied in the CESR Guidance that you do not consider to be important? Please identify factors and provide reasons.

No comment.

Q4. Do you consider that the requirements of Article 8(3) could be met without implementing any of the standards embodied in the CESR Guidance? If so, do you consider this would result in a greater or lower efficiency for CRAs and/or stakeholders? Please provide details. If there are less burdensome alternatives that would secure equivalent effects, please describe them.

The FBF supports the initiative of CRA regulation. However and as it has been shown by the ratings issued by entities based overseas, we also consider that the rating is an international point which requires also a better cooperation with other national authorities in charge of the CRA endorsement.

Q5. What factors, if any, might be relevant to ESMA in determining whether the frequency of assessment should be more or less frequent? For example, the CEBS "Revised Guidelines on the recognition of External Credit Assessment Institutions" published on 30 November 2010 suggests the level of assessment could be reduced for a rating methodology which is supported by quantifiable evidence of producing robust credit ratings.

Stability in methodology is clearly an important issue for both investors and issuers. It is quite challenging for them to anticipate rating actions if there is too much frequency in the changes in methodology (as it is currently the case for both financial institutions and sovereigns). We consider that rating process would be more transparent if there was more consistency in the assessment on accounting transparency and criteria. As long as rating methodology are based on confidential information there is a risk that rating agencies will not have the ability to make the due diligence which is essential to be sure that information provided by management are accurate.

Annual reviews are advisable for both issuers and investors, with additional reviews in case of specific developments.

Q6. Do you expect any of the standards embodied in the CESR Guidance, if transposed to RTS, to have any impact on existing or future credit ratings? If so, please specify which type(s) of rating (e.g. corporate, structured finance, financial institution, insurance, sovereign ratings) and what the impact(s) will be.

Please specify how the impact will occur and allocate the impact to each standard embodied within the CESR Guidance.

Done by banks themselves for internal purposes or by CRAs, ratings are among the elements taken into account to undertake many investments. By the way, we assume that RTS shall be balanced and precise in order to not prevent benefits granted by banks to the financial system.
Additional reporting requirements by the CRAs are extremely likely to be transferred to the issuers, in the form of additional data requests and increased annual fees. For the past few

years, rating agencies have for instance taken the habit of sending data requests directly to banks to fill up, pretty much in the same way the regulator would. These requests are becoming increasingly frequent and on diverse areas of banking, putting further pressure on bank resources.

Q7. Will the standards embodied in the CESR Guidance, if transposed to RTS, have an impact on market size, market structure and your position in the markets within which you operate? Specifically, do you expect?

a. Markets to grow, shrink or to remain unaffected? Please specify and explain.
b. Your competitive position to be enhanced or weakened? If so, please elaborate.
c. The introduction of prohibitive barriers to entry to new CRAs? If so, please elaborate.
d. Disproportionate impacts (e.g. market exit) on smaller or local CRAs? If so, please elaborate.

The FBF represents the banking industry in France and we think that it's not possible to give one answer to that question which depends obviously of the structure of the banks and its activities.

However, we know that where regulation is not well managed in economy and finance, the markets shrink and positions could be weakened. In any cases, the regulation on process shall lead to those situations in European Union which already faces challenges in the world global finance.

Increased regulation may convince some rating agencies to stop rating certain debt instruments, either structured or subordinated, which would have an impact on debt capital markets and the diversity of products available to investors.

Increased reporting requirements by the CRAs and increased appetite for financial and credit data de facto introduces barriers to entry for new or other CRAs, simply because CRAs methodologies are increasingly based on non public information. This in turn requires additional management time on the part of the issuer, which reduce availability to other CRAs, notably the small or local agencies.

Q8. What costs or benefits do you expect the standards embodied in the CESR Guidance, if transposed to RTS, to have on financial markets or the wider economy, for example, through?

a. Changes to regulatory capital holdings?
b. Effects on the price of raising capital?
c. Improvements in mitigating risks to the financial system?
d. Using credit ratings of better quality?

The cost and benefits analysis as presented require specific response for each banks, but our answer would be quite similar to Q7.

Improved regulation of CRAs is a welcome development as it should promote transparency and comparability of ratings.

CRAs have already started raising rating fees on structured products, making some of these instruments less profitable or even unprofitable. This in turn reduces funding sources for banks and their profitability.

Q9. Do you expect any other cost(s), benefit(s) and/or impact(s) that are not covered in these questions? If so, please specify.

The standards embodied in the CESR guidance however do not particularly promote competition in the CRAs market. Part of the problem is in our view linked to the fact that 3 agencies dominate the market and influence one another. While the agencies have gained in independence from the issuers, they are not independent from one another. Most changes in rating or rating methodologies are currently influenced by moves by another rating agency. We believe that the only way to change such a situation would be to move to an “investor pay” model, which would ensure that other rating agencies could gradually enter the market. Restricting CRAs to using public information only may also reduce barriers to entry to new CRAs.

The FBF would like to insist on the point that securization and covered bonds which are two important solutions to ensure liquidity shall not be ruled as negative as they are when ratings are fairly done.

II/ ON RATINGS DATA PERIODIC REQUIREMENTS FOR CRAS ACCORDING TO ARTICLE 21(3) (E) OF THE DRAFT AMENDED REGULATION »

Option for requesting analytical ratings data on a monthly basis

Q1. In your view, is there any redundant or missing information in the list in paragraph 9 which should be included or omitted in order to improve supervision?

Information received from the CRAs will give the means to better assessment of how the ratings have been done. The FBF is not opposed to the information which would be helpful for the ESMA as long as, banks activities which have been being overregulated in contrast to CRAs will not generate for banks some additional requirements.

It would be useful to add the reason behind a rating withdrawal (at the request of the issuer, due to a change in methodology, etc).

Q2. Please indicate the costs and benefits that you envisage from the analytical reporting requirements described above, for example regarding:

a. any specific reasons for an increase in the costs or a reduction in the quality or availability of the credit ratings as a consequence of the reporting requirements mentioned above;

b. any expected improvement in the quality of the credit ratings or credit rating processes and methodologies from CRAs in response to more effective supervisory activity;

c. any possible advantages linked to the increased potential for supervisory action to identify and address critical issues on specific ratings.

Please explain these costs and benefits, and where possible quantify them or provide examples.

We believe the main response from the rating agencies may be an upward revision of their rating fees.

Longer-term, the new regulation may however restrict the speed with which some rating agencies are changing their methodologies, which would be a positive development in our opinion. On structured products, methodological comments and updates have been issued almost every year for the past four years, making it difficult to adjust our operating processes (documentation, approval process).

Option of requesting aggregate ratings data on a monthly basis

Q1. In your view, does the list in paragraph 12 above include any redundant information or is it missing any relevant information? Please provide the relevant information, and reasons.

Information requested from CRAs intends to give more understanding of the ratings and its grounds. They consequently could be useful to the ESMA when performing its duties.

Q2. Please indicate the costs and benefits that you envisage from the content and frequency of the aggregate ratings data reporting described above, for example regarding:

a. any specific reasons for an increase in the costs or a reduction in the quality or availability of the credit ratings as a consequence of the reporting requirements mentioned above;

b. simplification and enhanced efficiency (possible more focused use of resources) of supervisory activity, driven by assessment of trends and identification of possible gaps or flaws in the rating sector;

c. higher efficiency in the use of supervisory resources – i.e. no need to analyse a large amount of data, with the possibility that any additional information may be requested when necessary from CRAs.

Please explain these costs and benefits, and where possible quantify them or provide examples.

Although rating agencies might be able to produce monthly rating data, we believe that a quarterly reporting may well be sufficient to maximise the use of supervisory resources and better allocate them to address outstanding issues related to CRAs, in our opinion, i.e.

1) The oligopolistic nature of the CRAs market
2) The existing barriers to entry to new CRAs
3) The problems created by the “issuer-pay” model compared to the “investor-pay” model