

21 October 2011

Mr Felix Flinterman
Head of Unit: Credit Rating Agencies
European Securities and Markets Authority (ESMA)
103, rue de Grenelle, 75007
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FRANCE

By Electronic Submission

Dear Mr Flinterman

Response of Moody's Investors Service ("MIS") to ESMA Consultation Paper 2011/302 on Regulatory Technical Standards ("RTS") on the information to be provided to ESMA by a credit rating agency ("CRA") in its application for registration and certification and for the assessment of its systemic importance pursuant to Regulation (EC) 1060/2010 (as amended, "the Regulation")

MIS appreciates the opportunity to provide feedback to ESMA on this consultation paper. In this covering letter, we set out our principle concerns with the RTS. In Annex A we respond to the initial 8 questions posed in the consultation paper. Annex B provides other comments on the draft RTS as requested in question 9.

(A) CRA owners and shareholders

MIS is concerned that ESMA is inappropriately expanding the scope of the Regulation by introducing into EU law, via this RTS, a disclosure regime on ownership of CRAs that was not provided for in the Regulation. It would appear that ESMA is seeking to use this requirement to tackle a perceived conflict of interest that might exist within a large shareholder of a CRA as stated in Recital 6 of the RTS. ESMA is proposing to impose a wholly new disclosure obligation on shareholders of CRAs but indirectly through CRAs in proposed Article 8(2) of this RTS. We are also concerned that ESMA is proposing to change the CESR Guidance¹ ("the Guidance") for major shareholders, which was aligned to normal disclosure rules precedent in the EU, from 10% to 5%² (Article 8 (1) (a) of the draft RTS). In both cases, we are of the view that ESMA is going beyond the scope of an RTS.

¹ Guidance on Registration Process, Functioning of Colleges, Mediation Protocol, Information set out in Annex II, Information set for the application for Certification and for the assessment of CRAs systemic importance (CESR/10-347)

² e.g. "qualifying shareholding" in a regulated entity in Markets in Financial Instruments Directive (2004/39/EC), Banking Consolidation Directive (2006/48/EC), Acquisitions Directive (2007/44/EC), Payment Services Directive (2007/64/EC), Second Electronic Money Directive (2007/110/EC) and Alternative Investment Fund Managers Directive (2011/61/EU).

Notwithstanding our comments about the inappropriateness of the use of RTS for these proposals, MIS is of the view that it may not be possible for a CRA to meet the disclosure obligation proposed in Article 8(2) of the RTS. Whilst a CRA may be able to obtain the details of shareholders from publicly filed information at a fixed point in time if its owners are publicly listed companies, it cannot do this in the case of an unlisted owner. Even if it were to ask that information of its shareholders, it would have no power to compel a response.

(B) Gaps in the RTS

MIS has identified the following two particular gaps in the proposed RTS:

1. The applicability of the RTS to EU registered CRAs

By the time this RTS becomes law, there will be more than a dozen registered CRAs in the EU. These CRAs would have been registered using the Guidance and not under the proposed RTS's more detailed and, in places, enhanced standards. It is unclear whether ESMA intends for a registered CRA to meet the requirements of this RTS retrospectively. If ESMA sought to do so, MIS believes that this would effectively re-open the registration process which would not be fair or proportionate given the length of the initial registration process. In particular, MIS would highlight Article 15 which, together with Annex VI, introduces a new fitness and appropriateness test for senior management and certain other staff. In the interests of certainty, MIS would suggest that this should only be applied when there are staff changes.

2. The location of the issuance of a rating

A key element of the Guidance was to determine the jurisdiction in which a rating was issued. This is an important element of any regulatory system in order to provide certainty to those who will be subject to regulation. Paragraph 158 of the Guidance stated:

"The CRA deemed to have issued a given rating and thus deemed legally responsible for that rating is determined by the location of the lead rating analyst (Article 3.1 (e)) upon the publication of the rating, and upon each subsequent review (including rating upgrades, downgrades and affirmations). Upon each review CRAs are required to disclose the name, job title and location of the lead rating analyst (Article 4.2, Annex I.D.1). CRAs should not shift a lead rating analyst to another CRA in order to circumvent the Regulation."

If ESMA is not in a position to include this in the RTS for legal reasons, then we would urge ESMA to maintain this aspect of the Guidance to avoid doubt as to the scope of the EU Regulation.

We would welcome the opportunity to discuss with you a number of the points raised in our response to your consultation paper.

Yours sincerely



Frédéric Drevon
Managing Director, Region Head of Europe, Middle East and Africa

Q1: Would you agree that the content of the Programme of operations set out in Annex X of the draft RTS is appropriate? If not, please, indicate the reasons or provide ESMA with further elements which could be included in the Annex. [NB we understand this question to refer to Annex IX]

Point 7(a) (f) MIS does not have one rating committee as implied by this point. We suggest the wording “pool of qualifying individuals who attend credit rating committees”.

Q2: Would you agree that the CRAs provide the criminal records of its senior management as set out in Article 15.2(a) of the draft RTS?

Whilst MIS believes that the fitness and appropriateness of senior management is of paramount importance, we are unclear as the legal basis for the proposals being made in this RTS as it is not a requirement covered in the Annex II. Furthermore, MIS regrets that ESMA has moved away from an approach based on self-declaration. MIS would, where possible, wish to provide criminal records to ESMA of such persons as ESMA required following consideration of a senior manager’s self-declaration, where MIS is able to and may lawfully obtain and share that information. Consequently in Article 15(2) we suggest that the words “which ESMA requests” after the words “senior management” be inserted and a time frame set out, rather than “recent criminal record” such as “a record dated within the last 12 months of the date of the application for registration of any criminal convictions within the last 10 years” and the insertion of the words “as far as it can reasonably and lawfully obtain and disclose this information.”

Q3: Would you agree with the content of the self-declaration that the senior management has to sign as set out in Annex VI of the draft RTS?

MIS suggests the following amendments to Annex VI:

In (a) “has been convicted of any criminal offence apart from minor traffic offences or other minor offences which did not involve dishonesty;”

In (b) “....disciplinary nature brought by a regulatory body or criminal nature;”

In (e) “....whose registration or authorisation was withdrawn by a regulatory body;”

In (f) “.....which require registration or authorisation by a regulatory body;”

In (h) “has been involved with an undertaking investigated or suspended by a regulatory body which resulted in enforcement action;”

In (j) “...dismissed from employment or other appointment in an undertaking as a consequence of allegations of misconduct or malpractice.”

Q4: Would you agree that the CRAs provide a copy of the outsourcing agreements instead of a description of its content?

No objection.

Q5: Would you agree with the level of detail regarding the information on the activities of the owners of the CRA described in Annex III of the draft RTS?

No. Please see our covering letter.

Q6: Would you agree with the proposed content of the inventory of conflicts of interest?

The words “and the outsourced rating activities” should be deleted from Article 21(2)(b) as this was not within the Guidance and the chain of connection is extending too far to be reasonably and practically complied with.

Q7: Would you agree that the content of the Programme of operations set out in Annex X of the draft RTS is appropriate? If not, please, indicate the reasons or provide ESMA with further elements which could be included in the Annex. [NB We understand this question to refer to Annex XII.]

MIS would point out that a certified rating agency that would be subjected to the systemic importance test would not, under Article 5 of the Regulation, be able to generate revenue from rating activity with EU based rated entities. Thus part of the second line of the revenue table appears to be misleading.

Q8: Would you agree that the statistics concerning the remuneration of employees are simplified?

Yes, we believe that this would facilitate the registration process.

Q9: Please, provide any other comments on the proposed RTS.

Please see below.

DRAFT RTS

As an overarching point of drafting, MIS presumes that the terms used in the RTS incorporate those defined by the Regulation but believes that it would be helpful if this were explicitly stated.

Comments on the Recitals

Recital (4) -We do not agree with the wording of the last sentence: “An applicant should provide a clear explanation for not submitting any specific information contained in that application”. A minimum information requirement should be expressly stated for all those requiring registration. The availability of any exemptions from the requirements should be objectively established in the law. Failing this there will be no transparency, for example, about any exemptions granted and may result in potential inconsistency between CRAs on the core information which is provided.

Recital (6) - We do not think that an RTS can be used to effect such a major change. Please see previous submissions on this point.

Recital (8) – Please see the comments to Q2 and Q3.

Comments on Articles**Chapter 2- REGISTRATION
SECTION 1- GENERAL****Article 3- Attestation**

We consider this provision impractical if there are many additional requests for information by ESMA of a CRA. We suggest that the initial attestation on the submission of the registration form expressly extends to all additional information supplied.

SECTION 2- OWNERSHIP STRUCTURE**Article 8-Owners and parent undertaking of a credit rating agency**

See comments under our covering letter and Q5 above.

SECTION 5-STAFFING AND COMPENSATION**Article 15-Fitness and Appropriateness**

In Article 15(1)(c) “internal review” should read “review” in line with the Regulation (Annex I Section A(9)).

Article 15(1)(d) describes “the heads of the quantitative teams responsible for developing and reviewing methodologies and models”. We do not understand who is meant by “quantitative teams” and would welcome clarification. There appears to be a misunderstanding as to how a CRA operates as again too great an emphasis is being placed on the quantitative criteria.

SECTION 8- CONFLICTS OF INTEREST

Article 22- Conflicts of interest with respect to ancillary services

The proposed requirement in paragraph 1 is a disproportionately onerous in extending the chain to the “shared” rating and ancillary services with a group of undertakings and should be deleted.

Section 11- OUTSOURCING

Article 25-Outsourcing requirements

At (d) we suggest the addition of the words “if in the possession or control of the credit rating agency” after “external report”.

Comment on Annexes

Annex III

INFORMATION TO BE PRESENTED WITH REGARD TO THE OWNERSHIP STRUCTURE

See comments at response to Q5 above.

Annex VII

ISSUANCE AND REVIEW OF CREDIT RATINGS

Point 1 (b) (ii): the words “model or key rating assumptions” should be deleted as Article 8(3) of the Regulation relates only to methodology.

Point 2(f): the word “approval” should be deleted before word “rating” as it is not accurate, and the word “approving” would be more accurately replaced with “determining”.

Point 2(h): the words “including education level or number of years experience” should be removed as they are not necessary criteria in assessing the suitability of the person involved in the rating decision.

Point 3(a): the words “or the entity to which the rated securities or instruments relate” should be deleted as they are not required to be notified under the Regulation.

Annex X

RECORD KEEPING, BUSINESS CONTINUITY PLANNING AND INFORMATION SYSTEMS

MIS understands ESMA’s interests in these issues but notes that they go beyond the requirements of Annex II of the Regulation.