Bundesverband
Öffentlicher Banken
Deutschlands e.V.

Verband deutscher
Pfandbriefbanken e. V

Comments by

the Association of German Public Sector Banks[1]
and
the Association of German Pfandbrief Banks[2]

ESMA Consultation Paper
Regulatory technical standards on the assessment of compliance of credit rating methodologies with the requirements set out in Article 8(3) of Regulation (EC) No 1060/2009

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[1] The Association of German Public Sector Banks – Bundesverband Öffentlicher Banken Deutschlands, VÖB – is a leading industry association in the German banking industry. It represents 62 member institutions including the regional banks (Landesbanken) as well as the development banks owned by the federal and state governments.
[2] The Association of German Pfandbrief Banks (vdp), headquartered in Berlin, currently represents 39 member banks. The association represents the Pfandbrief-specific interests of its member institutions in dealings with legislators, supervisory authorities, rating agencies and other market participants. It places its specialized services at the disposal of all Pfandbrief-issuing banks in Germany.

General remarks

The Association of German Public Sector Banks (VÖB) and the Association of German Pfandbrief Banks (vdp) welcome the opportunity to respond to the consultation paper on regulatory technical standards on the assessment of compliance with the requirements set out in Article 8(3) of Regulation (EC) No 1060/2009 published by ESMA on September 19, 2011.

In response to the financial crisis of 2008/2009 the members of the European Union agreed to a regulatory framework that would introduce comprehensive oversight over credit rating agencies, a sector that had been mostly unregulated. To us, the requirements of Article 8(3) are some of the most important requirements put forward in Regulation (EC) No. 1060/2009 as the methodologies and criteria that underlie each and every credit rating are among the most essential aspects of a rating decision. We therefore welcome any regulation that requires more transparency and strict rules in developing and applying rating methodologies.

More specifically, rating agencies should be required to outline and explain the underlying parameters and their effects within the model transparently and comprehensibly vis-à-vis regulators and market participants. This will allow authorities, issuers and users of credit ratings to fully understand the composition of a rating and evaluate its actual significance. Therefore, credit rating agencies should always consult changes to their methodologies and models with market participants before introducing them.

In addition, requirements for methodologies should include requirements for those that are applying those methodologies. Only those agency employees that possess adequate education, expertise and experience should be able to develop and apply rating models. Developing an adequate credit rating methodology necessitates a deep understanding of the respective sector both globally and nationally, strong knowledge of the regulatory environment, and excellent mathematical and theoretical skills. However, analysts should have the room and flexibility to take qualitative data such as bank-specific features into account.

Question 1: Do you agree with the list of requirements set out in the attached draft RTS to assess whether a credit rating methodology is rigorous?

We agree with the standards set out in Article 3 of the draft RTS. Especially, we would like to emphasize the obligations set out in paragraph 1(a) which require rating agencies to have clear and robust processes in place for the development and approval of its methodologies.

Credit rating agencies should always consult changes to their methodologies and models with market participants before introducing them. This should also apply to changes in correlations and other assumptions within the methodology. It would increase transparency vis-à-vis authorities, market participants as well as issuers and would ensure that methodologies are based on real-world market conditions rather than theoretical models.

Furthermore, credit rating agencies should also be required to follow a certain time frame. Especially in the event of a change to methodologies or models credit rating agencies should be obliged to publish information at a specific time, determined by the regulator. This will make the process for all market participants more predictable and reliable.

Additionally, we suggest creating an arbitration board that will help solve differences between market participants and credit rating agencies over the content and concept of proposed and applied methodologies. So far, past public consultations by credit rating agencies have not been effective to solve those differences.

Lastly, rating agencies should refrain from collecting data until the methodologies have been developed and published. Additionally, the requested data should only be limited to what is necessary for the model. A general data collection by credit rating agencies – independent from models and methodologies – must be avoided.

Question 2: Are there any other requirements that should be considered in the assessment of whether credit rating methodologies are systematically applied?

We agree with the requirements set out in Article 4 of the draft RTS. For us, the same assumptions, methodologies and conclusions should be applied consistently to comparable issuers or financial products. The credibility of credit ratings depends on their comparability across sectors and asset classes and therefore require a systematic application of rating methodologies.

Question 3: Do you agree with the list of requirements set out in Article 5 defining whether credit rating methodologies are continues?

We agree with the proposed requirements of Article 5 of the draft RTS. However, we would like to emphasize that the basic structure of the underlying credit rating model should remain unchanged for an extended period to guarantee the credit ratings' stability and credibility. Nevertheless, we agree that methodologies need to be responsive to changes and should be able to incorporate changes promptly.

In addition, continuity should not only be a requirement for ratings and their methodologies but also for analysts and agency employees in general. Whereas ratings and their methodologies should be reviewed frequently and, if necessary, adjusted, agency employees should similarly undergo a frequent assessment to ensure the highest quality of the overall rating process.

Furthermore, changes to methodologies that lead to changes in credit ratings should be communicated clearly and timely and should be consulted with market participants and issuers as formulated in Article 3(1a) of this draft RTS.

Question 4: Do you consider that these requirements would help ESMA in complying with its obligations set out in Article 22a?

We believe that the standards set out in Article 6 of the draft RTS would meet the requirements of Article 22a. To ensure a rating's validity and reliability we expect rating methodologies and models to be regularly validated. However, back-testing results and the underlying models should not only be documented and provided to ESMA, but should be published.

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