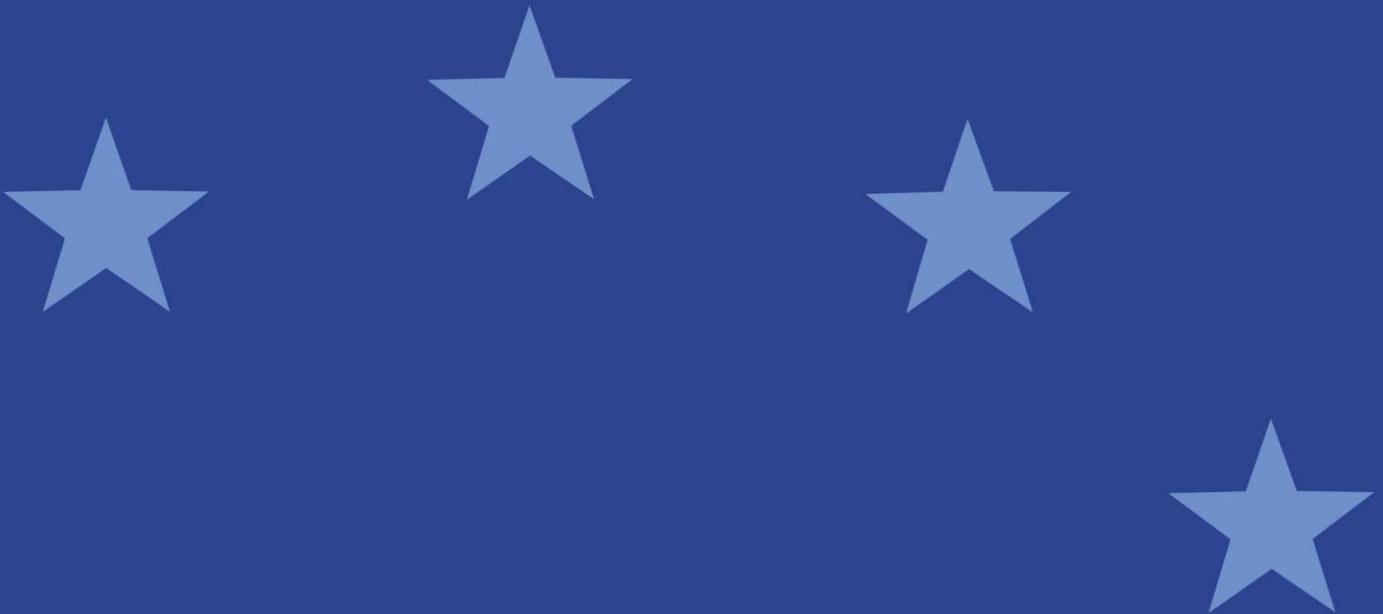




European Securities and
Markets Authority

Call for evidence

on the criteria for endorsement (Article 21 (2)(a) of the draft amended CRA Regulation)





European Securities and
Markets Authority

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I. Executive Summary

In the light of the proposal for amending Regulation (EC) No 1060/2009, ESMA has started the process of issuing and updating the guidelines on the application of the endorsement regime. The aim of this Call for evidence is to gather information from financial institutions and other interested parties which will be considered in the preparation of a public consultation paper (including a cost-benefit analysis) on the updated guidelines.

ESMA invites responses to this Call for evidence by 24/01/2011. All contributions should be submitted online via ESMA's website under the section "ESMA Work" heading "Consultation" at www.esma.europa.eu. All contributions received will be published following the close of the Call for evidence period, unless the respondent requests their submission to be confidential.

II Background

1. In June 2010, CESR issued guidance on the registration process and other matters (CESR/Ref. 10-347, Guidance) as required by Article 21(2) of Regulation 1060/2009 (Regulation). These guidelines also dealt with the application of the endorsement regime (Article 4(3) of the Regulation).
2. The impending revision of the Regulation will mandate ESMA to transform large portions of the present guidelines into regulatory technical standards. However, the endorsement regime will be subject to separate guidelines. These will be adopted by 7 June 2011. Therefore, although the endorsement rules in the Regulation will not be changed, according to the draft amended Regulation, ESMA will have to reconsider the initial guidelines on endorsement where appropriate in light of new developments and experience. In particular, the new guidelines will make ESMA, with effect from 1 July 2011, fully responsible for the supervision of European credit rating agencies (CRAs).
3. By means of this call for evidence, ESMA is seeking input from all interested parties, in particular CRAs and users of ratings, mainly on those aspects of the endorsement regime which have attracted particular attention or where ESMA perceives there is room for clarification. The responses received will feed into a consultation paper on the future guidelines.
4. The Call for evidence period closes on 24/01/2011. Respondents are invited to send their comments via ESMA's website (www.esma.europa.eu) under the section "ESMA Work" heading "Consultation". All responses that have not been labelled as confidential will be published on ESMA's website. ESMA will analyse the responses received and where appropriate revise its proposals accordingly.
5. The period for responses to this Call for evidence is shorter than ESMA's common practice due to the tight timeframe in which the consultation and issuance of the guidance has to be accomplished so as to ensure that it is adopted by 7 June 2011.

III Overview of the requirements set out in Article 4(3)

6. Since the entry into force of Article 4(1) of the Regulation on 7 December 2010, the use for regulatory purposes of ratings issued outside the EU is only permissible under the conditions set forth in Article 4(3) lit. (a)-(h). However, lit. (f)-(h) will only apply as from 7 June 2011. Hence, during this transition period, ratings can be endorsed and used for regulatory purposes even if:

- the issuing CRA is not registered or not subject to supervision (lit. (f)),
 - the foreign legal system does not prevent public interference with ratings (lit. (g)), and/or
 - there are no cooperation arrangements in place between the EU authority and its foreign counterpart (lit. (h)).
7. Furthermore, Article 4(3)(b) of the Regulation subjects the endorsement of ratings to the condition that: “the credit rating agency has verified and is able to demonstrate on an ongoing basis to the competent authority of the home Member State that the conduct of credit rating activities by the third-country credit rating agency resulting in the issuing of the credit rating to be endorsed fulfils requirements which are at least as stringent as the requirements set out in Articles 6 to 12”.
 8. Paragraph 108 of the Guidance on Registration provides that during the transition period “the endorsing CRA would, according to the Commission’s interpretation, be 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.”
 9. There has been a public debate on whether the expiry of the transition period will affect this interpretation of Article 4(3)(b) of the Regulation.
 10. In this context, paragraph 106 of the Guidance provides that upon expiry of the transition period “the requirements as stringent as those set out in Articles 6 to 12 may only be established in law or regulation of that third-country in order to satisfy the condition laid down in Article 4(3) (b).”
 11. In reviewing the guidelines under Article 21(2)(a) of the amended Regulation, ESMA will carry out a cost-benefit-analysis.

IV Discussion of policy options

12. ESMA assumes that the regulatory frameworks in a number of jurisdictions would not pass the “as stringent as” test required by the current CESR Guidelines. As a consequence, ratings issued in those countries would no longer be able to be used for regulatory purposes after 7 June 2011, until such time as the frameworks in question change.
13. However, even if one applied an “as stringent as” test on a self-imposed basis as suggested by some commentators, ratings outside the EU would not necessarily be able to be endorsed. In particular, the relevant EU competent authorities may have cooperation arrangements in place with only a limited number of third countries.
14. However, chances are that in the long term ESMA will be able to set up cooperation arrangements with an increasing number of countries which have some form of CRA framework in place. Hence, over time there should be more occasion to allow the use of non-EU ratings via endorsement than via the legal “as stringent as” test required by the current CESR Guidelines.
15. The transition to the final endorsement regime on 7 June 2011 may affect the capital requirements for firms subject to Directive 2006/48/EC (“CRD firms”) to the extent that ratings hitherto used for regulatory purposes (Article 3(1)(g)) might become unusable (Article 4(1)). According to Article 25(a) of the



amended Regulation, Article 4(1) will be enforced by the sectoral competent authorities of the member States.

16. Potential capital increases will depend, in particular, on:

- The use by CRD firms of non-EU credit ratings for regulatory purposes (i.e. calculation of capital requirements under the Standardised approach versus the IRB approach)
- The number and significance of the countries satisfying the requirements for endorsement
- The current and future places of issuance of credit ratings

17. Assessing the impact of the future interpretation of Article 4(3)(b) on CRAs and CRD firms is a highly complex exercise given the amount of information to be gathered from CRAs, CRD firms and banking supervisors alike and the need to combine these with one other.

18. In order to assess the costs and benefits as accurately as possible, the following questions are aimed at eliciting as much information as possible during the short timeframe available.

19. In the following, the term “non-EU rating” refers to a rating issued by a CRA (including a CRA belonging to a group of CRAs within the meaning of Article 3(1)(m) of the Regulation) which is domiciled in a non-EU country. It should be noted that the place of issuance of a rating is determined by the location of the lead analyst upon its first publication and when each subsequent review (upgrade, downgrade etc.) occurs (paragraph 158 of the Guidance). CRAs based within the EU, or those whose ratings are to be endorsed by an EU-based CRAs, are under a legal obligation to disclose for each rating that the credit rating is endorsed and to identify the lead analyst (Article 4(2), Annex I Section D.I.1). In this regard, ESMA further expects the disclosure of the name and the address of the office elaborating and issuing the credit rating (paragraph 159 of the Guidance).

V Questions

Please note that, the information regarding “non-EU rated” exposures should be provided with the following geographical breakdown: 1) North America (US and Canada), 2) Central and South America, 3) Asia (excluding Japan and Hong Kong) 4) Hong Kong and 5) Australia.

Questions for financial institutions

- 1) Please indicate the total non-EU rated exposures, distinguished by asset class, for which your organization/institution calculate capital requirements having reference to external credit ratings.
- 2) Please provide the breakdown by country of origin of the amount of non-EU rated exposures for which your organization adopts the Standardised approach to compute capital.
- 3) Please quantify the potential impact on the capital requirements of your institution under the assumption that all non-EU-rated exposures were unrated. Please provide this information according to the geographic breakdowns above.
 - a) In cases where ECAI credit ratings are not available, do you intend to use substitute ratings such as credit ratings produced by export credit agencies?

- b) In cases where ECAI credit ratings are not available, do you intend to use substitute methods such as the IRB approach?
 - c) Do you intend to decrease your regulatory use of credit ratings? Please provide detail to support your answer.
 - d) To what extent are external ratings used within your IRB modelling as both a factor within your models and as a validation tool? To the extent possible please differentiate IRB approach for securitisation and IRB non-securitisation.
- 4) Please quantify the potential impact on the capital requirements of your institution under the assumption that non-EU-rated sovereign exposures were unrated.
- a) In cases where ECAI credit ratings are not available, do you intend to use substitute ratings such as credit ratings produced by export credit agencies?
 - b) In cases where ECAI credit ratings are not available, do you intend to use substitute methods such as the IRB approach?
 - c) Do you intend to decrease your regulatory use of credit ratings?
 - d) To what extent are external ratings used within your IRB modelling as both a factor within your models and as a validation tool?

Question to all stakeholders

Please explain your main areas of concern regarding the application of the endorsement regime under Article 4(3) of the Regulation taking into account, in particular, paragraphs 73-111 of the Guidance.