STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

STANDARD & POOR'S RATINGS SERVICES RESPONSE TO ESMA'S DISCUSSION PAPER ON CRA3 IMPLEMENTATION DATED 10 JULY 2013

9 OCTOBER 2013

Standard & Poor's Ratings Services ("S&P") appreciates the opportunity to respond to the Discussion Paper on CRA3 Implementation issued by the European Securities and Market Authority ("ESMA") on 10 July 2013 ("Discussion Paper"). We note that ESMA is tasked with implementing Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies (the "CRA Regulation"). We understand that that this submission may be used by ESMA, along with submissions by other credit rating agencies ("CRAs") and market participants, in the drafting of regulatory technical standards in respect of information on structured finance instruments ("SFIs"), the European Rating Platform ("ERP"), and fees charged by CRAs to their clients.

Key points

Regarding Questions 1 – 20 (*Information on Structured Finance Instruments*):

- There is potential for overlap and inconsistency between the RTS and other regulatory disclosure obligations applicable to transaction participants.
- To avoid potential regulatory uncertainty we suggest that ESMA consider alignment with the categorizations used under existing SFI disclosure regimes.

Regarding Questions 21 – 37 (*The European Rating Platform*):

- We disagree with the suggestion that it is "necessary to include in the ERP also the press releases or the report containing the key elements underlying the credit rating". Article 11a(1) of the CRA Regulation ("Article 11a(1)") provides only for the submission of

rating information (as opposed to underlying documentation) and sets out a short list of specific items of information that are included within the term "rating information".

- The time period within which CRAs can reasonably submit data will, to a significant degree, depend upon the scope of the data that is required to be submitted. If the data were to be limited to the specific items of information expressly referred to in Article 11a(1), this would promote more rapid submission and minimize the risk of data submission errors.

- For the ERP to work most effectively, the priority should be to ensure the highest data quality and accuracy with robust quality controls whilst at the same time ensuring that the burden and the costs borne by CRAs in providing the data are kept within reasonable and proportionate bounds.

Regarding Questions 38 – 52 (*Fees Charged By CRAs To Their Clients*):

- The CRA Regulation and Discussion Paper make clear that Paragraph 3c of Annex 1, Section B of the CRA Regulation (the "Fee Provision") is designed to prevent CRAs undermining competition by unfairly lowering fees or by setting fees that unfairly discriminate between customers. It is not intended to impose price caps on CRAs or involve ESMA in fee setting.

- ESMA should be concerned with CRA costs only to the extent that cost information may shed light on conflicts, competition or unlawful discrimination concerns.

- The requirements of the Fee Provision can be met if CRAs set their fees using objective, non-discriminatory criteria and have policies and procedures in place to ensure individual clients or product types do not receive improper favorable treatment. The CRA's overall "costs" would be one of the factors considered in determining its fees, but not the only, or decisive factor.

1. Response to Questions 1 – 20 (*Information on Structured Finance Instruments*)

Introduction

Article 8(b) of the CRA Regulation ("Article 8(b)") does not place information disclosure responsibilities on CRAs themselves, but rather on issuers, originators, and sponsors of SFIs. However, in the credit rating process for SFIs, S&P uses information and data provided by issuers, originators, and sponsors ("Transaction Participants"). We therefore have views and insights on the disclosure of information relating to SFIs which may be helpful for us to share with ESMA.

As a preliminary matter, we note that there is potential overlap and inconsistency between the RTS that ESMA will draft and other regulatory disclosure obligations applicable to Transaction Participants. We note especially that various legislative measures applicable to banks already include certain disclosure obligations or incentives applicable to SFIs.

We note the recommendation of IOSCO to "build on existing initiatives on standardisation" of SFI disclosure regimes in the context of streamlining systems for provision of information and data processing. Potentially duplicative or contradictory requirements would generate unnecessary costs for Transaction Participants as well as for all users of such information.

Q1: Which categorisation of SFI asset classes should ESMA apply while developing the disclosure requirements?

In our view, the diversity of potential underlying collateral pool characteristics and transaction structures included within the broad definition of SFIs means that some form of asset class categorization scheme is required to shape the substance of the disclosure requirements (see Q6). However, as noted in the Discussion Paper, other existing asset class categorization

schemes require SFI-related disclosure, including the collateral programs of the European Central Bank ("ECB") and the Bank of England.

To avoid regulatory uncertainty we suggest that ESMA align its categorizations with those used under existing SFI disclosure regimes, while allowing a measure of flexibility. S&P does not favor any one categorization over any of the others.

Q2: In light of paragraph 13, do you consider that the scope of Article 8(b) should be limited to those SFIs which are covered by the Prospectus Directive and Transparency Directive, or that its scope should not be limited to those Directives and should cover all SFIs traded in the EU?

Applying Article 8(b) to all SFIs traded within the EU could make it cumbersome and over over-complicated as the definition of "trading" is vague and could include all activity on secondary markets, regardless of the location of participants. This would raise questions of how supervisory authorities will supervise and enforce compliance in the case of trades between non-EU Transaction Participants.

In our view, aligning the scope of Article 8(b) with that of the Prospectus Directive would be appropriate, so that Article 8(b) would cover SFIs traded on an EEA regulated market.

Q3: Do you consider that assets underlying SFIs composed of mixed pools should be disclosed as part of a specific category? If so, please elaborate.

More than most financial instruments, the characteristics of individual SFIs may vary significantly from one transaction to the next. Mixed collateral pools are one example of why the credit profiles of structurally similar transactions may be very different. Accordingly, it is difficult to formalize straightforward and meaningful categorizations for all possible underlying asset types and combinations.

While it may be helpful to consider broad asset class categorizations (as mentioned in Q1 above), we do not believe that the information required to assess an SFI's creditworthiness can necessarily be fully codified and determined in advance. In our own credit ratings analysis, while we may use pre-determined templates as a starting point to collect data and information, the data and information we ultimately request to rate an individual transaction depends on its specific characteristics.

We therefore believe that ESMA should formulate its disclosure requirements based on the economic substance of the transaction, rather than high-level categorizations based on underlying collateral type, structure, or legal form.

We further believe that whilst the disclosure of the assets underlying mixed pools as part of a specific category may be helpful in some cases, it may be problematic in many other cases.

Q4: To which tranching mechanisms should the disclosure requirements be applied? (e.g. single-tranche transactions?)

The definition of SFI in Article 3(1)(l) of the CRA Regulation refers to the definition in Article 4(1)(36) of the European Directive 2006/48/EC ("Article 4(1)(36)"). This definition appears to envisage an arrangement where cash flows from an underlying "exposure" or "pool of exposures" and is used to service at least two different stratified risk positions or tranches, reflecting different degrees of credit risk. In particular, the reference to "the subordination of transactions" in Article 4(1)(36) contemplates that there must be more than one tranche. As such, our understanding would be that single-tranche transactions are outside of the scope of Article 4(1)(36) and therefore outside of the scope of Article 8(b).

Q5: Do you have any other comments on the categorisation of SFIs?

No, please refer to the answers above for our comments on categorization.

Q6: In your view, which information is required to ensure a meaningful description of the SFI?

We believe ESMA should coordinate the substance of the Article 8(b) disclosure requirements with existing similar initiatives, retaining the flexibility to satisfy the requirements in various alternative ways, depending on the context (see our response to Q1).

In our experience, the information required for a meaningful description of all possible varieties of SFIs is difficult to generally define, as transaction structures and underlying assets can vary widely from transaction to transaction.

We note that in the context of S&P's credit rating process, while certain standard data and information disclosures may act as a starting point for the analysis, these may be materially supplemented by additional information requested from Transaction Participants depending on the economic substance of the transaction.

Q7: What kind of indicators/ratio do you think would be necessary to better monitor and model the performance of the underlying assets? Please indicate the relevant indicators for each of the asset categories?

As per our response to Q6 above, we believe the substance of the information reporting should be flexible and coordinated with other disclosure requirements.

Q8: For which category of SFIs should the disclosure requirements be adapted (e.g. where the underlying assets backing the SFIs are poorly granular)?

As mentioned above, we find that the reporting requirements in our own credit rating process are best kept appropriately flexible and determined according to what is appropriate for the transaction in question.

Pool granularity is a potential key area of distinction, with the required granularity levels to be carefully considered for each transaction. Insistence on granular reporting in some areas

may be counterproductive and may, for example, add unnecessary cost and complexity with little benefit to investors. Products such as RMBS may benefit from more granular (e.g. loan by loan) disclosure, while products characterized by more granular, revolving pools (e.g. credit card ABS) may be better suited to disclosure relating to the portfolio level or stratification data.

Q9: Do you have any other comments on the content of information to be disclosed?

No, please refer to the answers above for our comments on information content.

Q10: Do you have any comments on the alternative approaches outlined above (i.e. "event based" vs. periodic disclosure or a mix of both) regarding the frequency of the reporting?

Certain events may be critical in our rating surveillance of SFIs, as these can have material implications for the SFIs' ratings. Examples include changes to sovereign or related counterparty credit ratings, major credit events (such as the bankruptcy of the servicer), or material legal and regulatory changes. While these events may be material, their occurrence would generally be public knowledge. Requiring Transaction Participants to monitor and report such events would therefore likely be superfluous. Moreover, a purely event-based approach risks concentrating periods of data provision — potentially on multiple transactions — in short timeframes around significant events, which may not be practically feasible.

In our experience, regular surveillance of portfolio credit performance is better achieved by periodic reporting which enables investors to remain abreast of potential credit issues. The frequency of periodic reporting should reflect the nature of the underlying asset types and be aligned with the payment schedule of the SFIs. Reliance on event-driven disclosure would not meet the need for effective on-going surveillance.

Q11: In case of "event-based" approach, what (material) events should trigger a reporting update? In particular, please provide your views on SFI-specific events (e.g. performance of tranches and/or underlying assets)?

For the reasons outlined in our response to Q10 above, we do not believe that this approach is appropriate.

Q12: Should certain market events and thresholds (e.g. volatility, price movements, etc.) be identified ex ante that would trigger a reporting update? If so, please specify.

To the extent that the stated aim of Article 8(b) is to improve investors' ability to make informed assessments on the creditworthiness of SFIs, we do not believe market-related event triggers (such as those related to price movements) are necessarily relevant, as they may not be linked to the creditworthiness of the SFI. The difficulty with requiring updated reports in the event of such market events is prescribing in advance, with sufficient precision, what market events will require an update. An unduly prescriptive approach could result in excessive or inadequate reporting. Failure to capture events which cannot easily be predicted to affect performance increases the risk that these events are overlooked by investors and market participants.

Q13: Please provide your views on whether the disclosure requirements should apply to SFIs that are "live" at the date of the RTS coming into force or only to SFIs issued after that date?

ESMA should apply the disclosure requirements only to new SFIs. Applying the requirements retrospectively would place a disproportionate burden on Transaction Participants and raise a number of practical issues. An example might be an originator who no longer proposes to use securitization, or for so-called "orphan" transactions, where the originator is no longer an active entity.

Many legacy transactions are well-seasoned, with relatively short remaining time to maturity and supported by very high levels of credit enhancement as a result of structural amortization since closing. The benefit of increased disclosure in relation to such legacy transactions relative to the risk of disruption does not warrant the likely cost of such increased disclosure, in our view. Further, applying new disclosure requirements to existing transactions would affect legacy investors, who may need to update their monitoring systems to ensure compliance with other regulations, even though they may have no intent to invest in securitizations in the future. It would seem to contribute most to the future conduct of the markets for the focus of issuers' and investors' cost and attention to be on increased transparency in new and future transactions.

Q14: If the reporting obligation were to apply to "live" SFIs, what do you think would be an appropriate phase-in period or schedule?

As outlined in our response to Q13, ESMA should apply the requirements only to new SFIs.

Q15: Do you have any other comments on the frequency of the reporting? Do you think any other approach should be considered?

No, please refer to the answers above for our comments on reporting frequency.

Q16: Are different templates needed for each of the asset classes subject to the disclosure requirements?

The requirement for comprehensive and well-informed stress tests on SFI cash flows and underlying collateral values will likely require different types of data reporting for different transactions and asset classes. For example, S&P assesses credit card ABS on the basis of aggregate pool-level information, while we generally assess RMBS on the basis of loan-by-loan

information for the underlying collateral pool. However, given the difficulty of generalizing requirements, we believe it is difficult to specify in advance what might be appropriate and relevant for every SFI. As discussed above, we believe that reporting requirements should therefore not be overly prescriptive and allow flexibility in data and information provision.

Q17: Do you consider that the scope and content of the ECB templates set to report loan-level data are appropriate for addressing CRA 3's disclosure requirements?

S&P cooperates with the ECB and the European Data Warehouse to facilitate standardization of data templates and data provision to the European Data Warehouse. S&P has integrated these templates into its own on-going data collection efforts and is testing the RMBS loan level data within the warehouse for its own use. The ECB initiative has already made significant progress towards standardization and market adoption and we would encourage alignment with such existing initiatives to minimize costs for market participants.

However, while it may be appropriate to recognize disclosure that already meets the ECB reporting requirements as equivalent to the disclosure required under Article 8(b), we believe this form of reporting should only serve as one of the possible means of compliance. For example, some transactions may not be intended for ECB collateral eligibility, and may therefore not be aligned with ECB reporting templates, but may instead be aligned with other reporting initiatives, which could be equally sufficient to meet the requirements under the CRA Regulation. To avoid confusing an already tentative SFI market, ESMA's RTS should build on or endorse the various existing disclosure regimes, rather than adding additional overlapping or contradictory requirements.

Q18: Do you consider that the data collected through the ECB templates would allow other investors to conduct comprehensive and well-informed stress tests for their own specific requirements on the cash flows and collateral values supporting the underlying exposures? If not, explain what further information should be reported (e.g. prospectus, transaction

summary, pool performance data, credit support information, investor reports, due diligence reports) and, if applicable, please consider other relevant reporting requirements.

We note that there is no definitive minimum data requirement to perform stress tests on SFIs, since the data required will depend on the nature and sophistication of the stress test being employed. In general, we assume that stress tests take as an input some description of credit stress and consequent performance of the underlying collateral pool and have as an output the corresponding effect on cash flows to the related SFIs. The core requirement to facilitate this form of test is a description of how collateral cash flows translate through the transaction structure into cash flows to the SFIs. Such basic information is not the focus of the ECB collateral reporting templates, but is simply a fundamental element of how the transaction operates and therefore is included in documents that are in any case widely available, e.g. through the documents disclosed pursuant to the disclosure requirements under the Prospectus Directive.

Q19: Apart from the national or Union law governing the protection of confidentiality of information, should the context of local securitisation framework for specific asset classes be also considered?

We have no comments.

Q20: Do you have any other comments on the provision of Article 8(b) (3) (c) concerning the standardisation of the information to be used?

No, please refer to the answers above for our comments on standardization.

2. Response to Questions 21 – 37 (*The European Rating Platform*)

Q21: Particularly for users of ratings: Taking into consideration the rating classification described above, could you suggest (including a detailed reason):

a. other rating types not captured in the above categorisation;

b. which rating categories or rating components should ERP cover;

c. other actions or events affecting the ratings, that should be published on the ERP.

We have no additional suggestions in relation to the rating classification described in paragraphs 29-32 of the Discussion Paper. This classification covers all ratings types, rating categories and rating actions in relation to which information is currently being provided to ESMA by S&P via SOCRAT and CEREP.

Q22: For displaying the press release information, which of the two options do you prefer and why? Particularly for CRAs: Can you provide evidence on costs that you would incur under the two proposed options? Could you suggest other ways of retrieving, storing and make available on the ERP the press release information?

As a preliminary point, we disagree with the suggestion made in paragraph 34 of the Discussion Paper that, in order for ESMA to fulfill its legislative mandate, it is ”necessary to include in the ERP also the press releases or the report containing the key elements underlying the credit rating”. The relevant provision of the CRA Regulation (Article 11a of the CRA Regulation) makes no reference to press releases or reports. Article 11a(1) provides only for the submission of rating information (as opposed to underlying documentation evidencing or explaining that rating information) and sets out a short list of specific items of information that are included within the term “rating information”. It is clear from this list that it is envisaged that CRAs should provide discrete items of data concerning credit ratings and rating outlooks which can readily be submitted by the CRAs and displayed on a website rather than detailed

information or explanations concerning the elements underlying the credit ratings and rating outlooks. Moreover, Article 11a(2) of the CRA Regulation provides for ESMA only to publish "the individual credit ratings submitted to it pursuant to paragraph 1", although we accept that this was probably intended to refer also to the other specific items of information listed in paragraph 1 (namely, the rating outlooks, the type of credit rating, the type of rating action and the date and hour of publication) and not just the credit ratings themselves. Accordingly, we do not consider that there is any legislative basis for ESMA to require CRAs to make all their press releases and reports permanently available for publication on the ERP.

The CRA Regulation does, of course, specifically require certain information to be published by registered CRAs in their publications and/or on their own websites. However, CRAs are not required to make all their press releases and reports relating to credit ratings and rating outlooks permanently and freely available to the public on their websites. Press releases in relation to S&P's credit ratings and rating outlooks are made freely available on our public website (www.standardandpoors.com) for a period of time, after which they are accessible through the rating-specific regulatory disclosures. Although we do not consider that the terms of the CRA Regulation require it, we would have no objection to ESMA providing for the ERP to contain hyperlinks to the relevant press releases or the relevant sections on S&P's public website.

Q23: Shall the ERP provide supporting rating information in addition to the press releases/report? If so, what kind of information on the rating / rating action would be beneficial?

As stated in our response to Q22 above, we do not consider that there is any basis under the CRA Regulation for CRAs to be required to provide press releases / reports for publication on the ERP (although we have no objection to providing hyperlinks to such press releases / reports whilst they are freely available on our public website). In the same way, there is no basis for CRAs to be required to provide for publication on the ERP any other "supporting rating

information", whatever that term may be interpreted to include. Moreover, we understand that the intention behind the ERP is that specific items of key information in relation to the credit ratings and rating outlooks published by different CRAs concerning the same entities or instruments should be displayed in one place in a clear way to enable their ready comparison. We consider that inclusion on the ERP of extensive supporting information from all CRAs in relation to all credit ratings and rating outlooks would be contrary to this intention in that it would make the website cumbersome to use. To the extent that individual users are interested in obtaining specific items of further information from specific CRAs (and different users of credit ratings may have widely diverging interests) they would be better accessing the websites of the relevant CRAs directly to see what is available. As stated above, we have no objection to hyperlinks to our public website being included on the ERP.

Q24: Particularly for users of ratings: Which option do you consider as the best option for displaying the data on the new ERP? Please specify the specific time frames (if different from the proposed ones).

The time period within which CRAs can reasonably submit data will, to a significant degree, depend upon the scope of the data that is required to be submitted. If the data were to go beyond the credit rating or rating outlook, the type of credit rating, the type of rating action and the date and hour of publication (i.e. the specific items of information expressly referred to in Article 11a(1)), this would tend to increase the burden on CRAs, slow down submission and increase the risk of data submission errors and thereby reducing the timeliness and usefulness of the ERP compared to submission of data as set out in Article 11a(1).

Lastly, we would request that ESMA sign a no redistribution contract or provide assurances to the CRAs so that CRA intellectual property is appropriately respected.

Q25: Particularly for users of ratings: As regards options (c) and (d), in case of the ratings reported on a Friday or before a bank holiday, when the rating information has to be made available on the ERP: on the next calendar day or the next working day?

We have no view on when information should be available on the ERP. However we do not consider that CRAs should be required to submit data to the ERP on non-working days, as weekends and bank holidays tend to be the times when CRAs require system downtimes for disaster recovery exercises, regular maintenance schedules and application of server patches etc.

Q26: Particularly for CRAs: which of the two possible ways of sending the new rating/outlook information to the ERP is more suitable to be integrated in your IT system: the real-time automatic data-feeds or one daily batch? Please provide a detailed motivation for your choice and include in your answer also reference to the actual costs that you would incur under the different submission options.

Requiring the submission of real-time automated data-feeds would involve additional costs of establishing systems capable of transmitting data separately, and almost instantaneously, in relation to each of the numerous rating actions each day, and integrating those systems with our existing systems, would be very extensive. We would also incur substantial costs in enabling our systems to submit the required data relating to all rating actions in a single batch, but the costs would not be so extensive as for real-time submission. It is difficult to estimate what the likely costs would be without knowing the details of what data we would be required to submit and in what form. However, it is likely that we would at least need to purchase new hardware and storage capacity and hire significant additional resources to provide IT, data management and risk management services. A first, rough estimate puts S&P's operational and administrative costs at 20 to 25 times the equivalent of CEREP. In addition, real-time submissions may not allow sufficient time for the required quality controls and correction processes that would more likely guarantee the highest quality ERP data.

Q27: Can you suggest any other options for reporting the rating information to ESMA and for the publishing of the received rating information on the ERP?

We refer to our answers to the above questions concerning our views on the submission of data for publication on the ERP. In addition, we suggest that ESMA consider directing users, and/or including hyperlinks, to the CRAs' public websites where they can find ratings data and information disclosed in accordance with the CRA Regulation. We also recommend that ESMA allows for time between the submission of the data to ERP and publication to review the data.

Q28: Particularly for users of ratings: Which information should be added to the rating information to facilitate the comparison across ratings from different CRAs on the same entity while avoiding misunderstanding on the meaning of each rating? Under which form should this information be displayed (full reports, aggregated information, direct links, reference to the CRAs website, etc)?

As stated above, we suggest that ESMA consider providing direct hyperlinks to the CRAs' own public websites where users can locate additional published information. Information on a CRA's criteria and its rating scale could be provided by expanding the existing CEREP qualitative data file.

Q29: Particularly for CRAs: Do CRAs envisage any difficulties on mapping your current internal identifiers with the new LEI for the rated entities?

We do not currently foresee any significant obstacles to mapping the LEI to our existing internal identifiers for rated entities. However, in order to reduce any potential challenges, we suggest that ESMA provide clear rules for mapping from the LEI system to the internal identifiers and from the CICI (CTFC Interim Compliant Identifier) identifiers to the LEI system.

Q30: Particularly for CRAs: Are there other common issuer identifiers that the ERP could use in order to allow for a mapping of rated entities?

We do not know of any other common issuer identifiers that the ERP could use.

Q31: Particularly for users of ratings: Could you provide suggestions on how ERP could present the rating information so as to allow an easy access and understanding of the rating data? If possible please provide a clear description and/or a visual representation like the one given above.

As explained in our answers to the above questions, in particular Q22, we consider that the ERP would be less cumbersome and easier for users to use, would be less likely to cause confusion and could more readily be kept accurate and up-to-date by CRAs, if the information that it contains is limited to the key items of data concerning a rating that are expressly referred to in Article 11a(1). As also explained above, we consider that it would go beyond ESMA's legislative mandate under the CRA Regulation to require provision of more extensive information in any event. For these reasons we consider that the appropriate position would be for the ERP to display the following information: rated entity / issuer, issue name and series/tranche name (if applicable), date of rating action, type of rating action, credit rating (including type) and CreditWatch and/or Outlook status.

We also recommend that the ERP provides access to the data in the existing CEREP qualitative file, which includes descriptions of rating scales and links to the CRAs' credit rating methodologies.

Q32: Particularly for users of ratings: Besides the access via a web page, which other means of accessing the ERP do you consider relevant?

We consider access via a webpage to be the most practical and appropriate mechanism especially if hyperlinks to the CRAs' own public websites are going to be included.

Q33: Particularly for CRAs: Would you agree with having just one individual data feed to ESMA in order to report to the ERP, CEREP and SOCRAT?

We can see some attraction in submitting one data set in relation to ERP, CEREP and SOCRAT. However, we consider that ESMA's priority should be on ensuring the highest data quality and accuracy with robust quality controls whilst at the same time ensuring that the burden and the costs borne by CRAs in providing the data are kept within reasonable and proportionate bounds. One substantial difficulty that we see with this proposed approach is that the reporting frequencies of CEREP, SOCRAT and ERP are not the same which could challenge the usefulness of a single data set.

Q34: Particularly for users of ratings: do you agree with the proposed option? (Please state the reasons for your preference).

While we understand that ESMA would like to display historical credit ratings information on the ERP, in our understanding the ERP was meant to contain current credit rating data. Indeed, Recital 31 of Regulation 462/2013 sets out the different and complementary objectives of the ERP and the CEREP by stating "The European rating platform should incorporate ESMA's central repository with a view to creating a single platform for all available credit ratings per instrument and for information on historical performance data, published on the central repository." While Article 11 of the CRA Regulation specifically sets out that CRAs must make available to the CEREP "information about credit ratings issued in the past", neither Recital 31 nor Article 11a uses such language for the ERP. To this end, and in order not to unnecessarily interfere with the CRAs' intellectual property rights, we recommend that CRAs instead be asked to provide the outstanding credit ratings on the effective date 21 June 2015 and subsequent credit rating changes.

Q35: Particularly for rating users: Do you consider it of use that the ERP would provide for a mapping of rating scales to improve the comparability of ratings of different CRAs?

The possibility of establishing one or more mappings of credit ratings submitted to the ERP will be the subject of a specific report which ESMA is required to submit to the Commission by 21 June 2015 pursuant to Article 21(4b) of the CRA Regulation. The preparation of that report should be the subject of a separate, detailed consultation conducted nearer to that time. We therefore consider that it would be premature for the ERP to provide for a mapping of credit rating scales before that detailed consultation has been conducted and the Commission has considered ESMA's full report.

Reasonable professionals who assess creditworthiness can and do differ in how to define, analyze and interpret credit factors. The market and investors benefit from having more than one approach. The key is that each CRA should communicate clearly what its credit ratings mean and the methodology used to arrive at its credit ratings. We believe that the investing public will be better served not by the use of a mapping system that may suggest a perceived equivalence, but by a clear understanding of what the credit ratings of each CRA signify, and how they are determined. Having multiple assessments based on different methodologies, conveyed in a transparent fashion, provides more information to the market. By contrast, enforcing a mapping between rating scales would suggest that particular credit ratings issued by different CRAs are equivalent and could act as a disincentive to investors and other market participants to fully understand the differences in methodologies, definitions and approaches. This demonstrates the importance of making available to users of the ERP the CRAs' individual credit rating scales (as in the CEREP qualitative file) and methodologies.

Q36: Are there any risks or implications with regard to mappings of rating scales in view of the distinct methodologies employed by CRAs? How should such risks be mitigated?

Mapping between the differing rating scales used by different CRAs may have unintended consequences and risks. It may effectively lead all users of credit ratings to view the

credit ratings as equivalent in terms of methodologies, definitions, quality, predictive value and robustness of analytical approach even when the CRAs publicly disclose that they take different approaches to analyzing creditworthiness. It may therefore not be consistent with the EU-endorsed Financial Stability Board's Roadmap for reducing reliance on CRA ratings. We believe that investors benefit when there are numerous differing opinions and users of credit ratings can consider some or all of them, affording them differing weights according to their own analysis of the different methodologies. This will be a key issue when ESMA prepares its report on the possibility of establishing the mapping of credit ratings pursuant to the mandate in Article 21(4b) of the CRA Regulation and we would look to comment further on it as part of that process.

Q37: What features should a mapping of credit ratings have? Which methodology should be followed?

As stated above, we consider that it is premature to consider providing a mapping of credit ratings or credit rating scales on the ERP ahead of the report to be drafted by ESMA in accordance with Article 21(4b) of the CRA Regulation.

3. Response to Questions 38 – 52 (*Fees Charged By CRAs To Their Clients*)

Introduction

The Fee Provision requires that "fees charged are non-discriminatory and based on actual costs". The Fee Provision is to be read in conjunction with the express legislative purpose (as evident from Recital (38) to the CRA Regulation) to further mitigate conflicts of interest and facilitate fair competition in the credit rating market by ensuring that fees are not discriminatory. As the Discussion Paper makes clear, the Fee Provision was not intended to impose price caps on CRAs, or involve ESMA in fee setting discussions. Such a reading would also be inconsistent with the text of the provision, which stands in contrast to the "cost orientated" wording used in

EU legislation regulating "network industries" such as electronic communications and electricity characterized by the essential nature of the services they provide and their physical barriers to entry. Rather, the Fee Provision should be read as requiring that CRAs do not undermine competition by unfairly lowering their fees to undercut new entrants to, and existing competitors in, the CRA industry, or unfairly discriminate as between the CRAs' respective customers.

The Discussion Paper acknowledges that the CRA industry has a complex and diverse cost structure, which we believe differs fundamentally from that of utilities or indeed other service industries. We also agree there is not a single concept of cost and that the total cost of the service provided by CRAs encompasses a great variety of different elements or components. A broad definition of costs will promote innovative business practices and fair competition among CRAs, whilst a restrictive definition of cost confined to narrow, quantifiable concepts such as overheads, labor and electricity would be inconsistent with the realities of the CRA industry. Certain types of costs, such as reputational risk and civil responsibility, may be difficult to quantify in advance and on an individualized basis, and thus to report as a percentage of a CRA's fees. But CRAs may take these costs into account when setting their fees, effectively reflecting the value that ratings provide to the market. We believe that consideration of the varying risks and values to the market of different ratings - depending upon the amount and type of debt, market conditions and industry dynamics - should be permitted and indeed encouraged in the implementation of the Fee Provision.

S&P does not understand the phrase "based on actual costs" to mean that cost should be the *only* or decisive factor in determining fees, or that there should be a mathematical relationship between costs and fees. Such a reading would not be consistent with the CRA Regulation's goal of encouraging competition and would in effect transform the Fee Provision into a price cap and/or fee setting regime, leading to unintended and counterproductive economic consequences such as for instance reducing variety and flexibility in the CRAs' fees setting (and thereby price competition) and creating an undue emphasis on the relationship between the time taken by an analyst on a particular rating and the fees charged. We believe the requirements of

the Fee Provision and the goal of avoiding discrimination in order to mitigate conflicts of interests and increase competition can be met if CRAs set their fees using objective criteria which do not discriminate among similarly situated customers, and have policies and procedures in place to ensure individual clients or product types do not receive improper favorable treatment. The CRA's overall "costs" would be one of the factors considered in determining its fees, but not the only, or decisive factor.

To apply the Fee Provision consistent with the foregoing will require a careful, market sensitive approach. Data and reporting requirements related to the Fee Provision, including those under the RTS, should be proportionate and tailored to assist ESMA in addressing the goals of the CRA Regulation without imposing unnecessary burdens on ESMA or industry participants. Several proposed periodic data and reporting requirements set forth in the Discussion Paper are generally consistent with that approach. Others, we believe, fail to reflect the above considerations, including that different cost factors be of different significance depending on the CRA's specific business-, cost- and pricing- model and individual circumstances.

Q38: Do you consider that identification of "common practices" (within a CRA and across the CRA market) can help to identify discriminatory and non-discriminatory practices?

Given the complexity and diversity of cost structures in the CRA industry, it is unlikely that divergence from "common practices" concerning fees — to the extent they exist — is evidence of discriminatory practices. In our view, divergence in practices reflects the complexity and diversity of industry organizational (and hence cost) structures, themselves resulting from efforts to service broader client bases and numerous geographies as well as to compete and innovate. The requirement that CRAs identify any such practices will not advance the stated goals of the CRA Regulation, and could reduce competition and innovation.

The requirement would discourage competing price and cost structures within the industry and is inconsistent with principles of EU law. For example, in one well-known case, the

General Court stated: “the independent determination by each economic operator of his commercial policy and in particular of his pricing policy corresponds to the concept inherent in the competition provisions of the Treaty.” *See* Case T-229/94, *Deutsche Bahn AG* v *Commission* [1997] paragraph 38. Other potential unintended consequences include the difficulty of CRAs offering their clients the best services at the most competitive price and making it more difficult for new entrants to develop innovative pricing models. By contrast, the items listed in paragraph 87 of the Discussion Paper have more relevance to identifying potential discriminatory practices without as much of a risk of diminishing competition.

Q39: Do you agree on the proposed periodic reporting illustrated above to be submitted by CRAs to ESMA on the application of their pricing policies and calculating their fees? Do you think there are other relevant criteria that should be included to allow ESMA to monitor the non-discrimination requirement?

We believe the reporting requirements listed in paragraph 87 of the Discussion Paper are generally an appropriate method to advance the purposes of the CRA Regulation in avoiding price discrimination and conflicts of interest. For example, “whether CRAs have adopted a pricing policy for rating services” ensures that pricing is consistent with a set price structure. At the same time, it allows each CRA to develop price and cost structures that will allow it to offer its customers the best service for a market competitive price. However, in light of our introductory remarks we do not see why information about “whether rating and follow-up processes are budgeted in written form and dated” would be necessary to monitor compliance with the Fee Provision irrespective of the individual CRA’s circumstances. Such a requirement would create an additional layer of administration and would burden new entrants more than established CRAs.

We also believe the Discussion Paper fails to recognize the distinction between market-beneficial price variation and market-prejudicial price discrimination. Price variation reflects the reality of price competition and ESMA should distinguish between instances where price

discrimination can hinder competition (such as where it is used to exclude competitors) and instances where price variation promotes competition (such as where it enables firms to effectively compete for new customers). Indeed, the academic literature strikingly demonstrates that lawful price variation in concentrated markets (such as the CRA industry) can intensify competition and benefit consumers. For example, in concentrated markets with repeated purchases, sellers often use repeat clients' past purchase information to offer lower prices to such clients, as lower prices are largely based on informational efficiencies arising from such clients' past purchases, and thus incorporate explicit dynamic considerations. In addition, the European Commission and the EU Courts have generally considered that quantity rebates reflecting cost efficiencies are compatible with Article 102 of the Treaty on the Functioning of the European Union. Accordingly, CRAs should be permitted to adhere to a similar practice and offer alternative pricing options that can result in a lower effective cost and allow them to offer a lower price compared to their standard transactional fee schedule.

S&P's alternative fee options are available to all clients. These options are implicitly "cost-based" since they are offered in circumstances that result in time and resource efficiencies or in circumstances that provide a more predictable revenue stream to a CRA.

It goes without saying that clients and competition would benefit from discounts resulting from commercial negotiation initiated by clients, as long as there is no anticompetitive intent or effect.

Q40: What is the frequency with which such reporting should be provided to ESMA?

We suggest annual reporting.

Q41: Particularly to CRAs: what are the criteria you are applying or plan to apply to ensure fees are non-discriminatory?

S&P's pricing practices are based on criteria such as the perceived economic value of the rating in providing an informed opinion, analysis and transparency to the market, as well as other objective criteria such as the complexity of the instrument or issuer to be rated, and the risks and costs involved in producing the rating. Entities with an S&P rating benefit from its experience and market reputation for offering an independent credit perspective. S&P maintains practices and policies that aim to ensure that the rating process is non-discriminatory. For example, S&P has written fee schedules for different types of debt obligation (corporate, financial institutions, structured finance, etc.) it rates. These schedules are reviewed at least annually using consistent principles. Any material deviations are subject to a formal approval that includes senior management. Under no circumstances do S&P's fees depend on the level of the credit rating issued or on any other result or outcome of the work performed. Further, the fees charged for a rating service in a particular sector are based on the type and amount of the issuance, and the complexity of the transaction documentation, irrespective of who the client is.

In setting fees, S&P will continue to follow the practices and criteria summarized above and further explained below, in particular in its response to Q50. S&P will continue its practice of uniformly applying its fee schedules for individual types of instruments — the same fee will be offered to similarly situated customers seeking similar rating services. In addition, S&P intends to continue to offer multiple fee options to all entities.

Q42: Do you agree on the approach to assess whether fees are dependent on the level of the credit rating issued by the credit rating agency or on any other result or outcome of the work performed? Do you consider that other approaches or criteria should be applied? What cases do you think should be comprised in the concept "any other result or outcome of the work performed"?

ESMA's approach to ensure that fees are not tied to rating outcomes appears consistent with many of the practices listed in paragraph 87 of the Discussion Paper.[1] Subject to the qualifications and reasoning set out in S&P's responses to Q38-39, S&P generally believes that this approach can help to avoid unlawful price discrimination and maintain ratings independence.

The phrase "any other result or outcome of the work performed" could refer to other feedback the client might receive from a CRA during the rating process, such as how a particular transaction feature would be treated under the CRA's ratings criteria. However, care should be taken if the phrase is interpreted to include the practice of a CRA arriving at a preliminary rating but *not* issuing a final rating because, for example, the client either (i) goes with another CRA's rating, (ii) believes it can issue the security without a rating, or (iii) because market conditions deteriorate making issuance impracticable. In these situations, the fee may well be different because the CRA is not actually publishing a rating and, thus, some of the risks and costs associated with that rating are different. Such practice does not contradict the legislative intent of the Fee Provision and in fact discourages rating shopping.

Q43: Do you agree on the approach to assess whether fees are dependent on the provision of ancillary services? Do you consider other approaches or criteria should be applied too? Do you consider that a risk indicator (percentage) between ancillary services fees and the rating and follow-up fees from a rated issuer or any related party can help to identify possible discriminatory practices? If so, what percentage do you consider appropriate? What would you consider a "significant" percentage?

The ratio of ancillary service fees to rating fees does not necessarily indicate a dependence between the two. A CRA's revenues from ancillary services could be significant without there being any dependence between the rating fees and the provision of such ancillary

[1] S&P understands the reference in paragraph 89 to "section II.I" to be a reference to section IV.I(a) of the Discussion Paper.

services. Again, we believe that consistently applied fee setting principles are the most effective way to ensure that ratings fees are not dependent on factors prohibited by the CRA Regulation. S&P would be concerned if a focus on numerical "risk indicators" lead to limitations imposed by ESMA on the share of a CRA's revenue from ancillary services, for which neither the Fee Provision nor Recital (38) to the CRA Regulation provide any justification.

Q44: Particularly to CRAs: what are the criteria or practices you are applying or plan to apply to ensure fees are not dependent on the level of the rating issued by your agency or on any other result or outcome of the work performed? What are the criteria or practices you are applying or plan to apply to secure fees are not dependent on the provision of ancillary services?

S&P has never used the "level of the rating" as a component of its fee-setting process. In determining rating fees, S&P uses, and will continue to follow, the policies and practices described below, in particular in its response to Q50. S&P's rating fees are, in general, agreed before material analytical work in a rating begins. In accordance with S&P's Roles and Responsibilities policy, the negotiations do not involve the analysts (although, in some cases, analysts may be asked about the complexity of a transaction).

Along with the separation of S&P's commercial fee unit from the rating analysts, the absence of any direct, mathematical link between overhead and other costs and rating fees helps insulate analysts from the ability to influence the fees charged to the companies or sovereigns that they rate. For the avoidance of doubt, as noted below, S&P's fees are determined by considering a broad range of factors, but not in a manner that could be expressed using a formula or algorithm.

S&P will continue to ensure that its ratings fees are not dependent on the level of ancillary services by continuing to follow its existing policies and procedures. Pursuant to these, ancillary services are not a relevant factor in the fee-setting process.

Q45: Particularly to CRAs: do you have cost synergies between rating services and non-rating services other than ancillary services? In that case, please specify what these synergies are and how costs for non-rating and non-ancillary services are allocated to your rating services?

As a global organization, there are certain costs, such as IT, accounting, audit, legal and related costs that are incurred by S&P's parent company, McGraw Hill Financial, and allocated to various business units, including the ratings business.

Q46: What are your views towards the approach that different business models and fee structures should be taken into account when assessing whether fees are cost-based?

ESMA has, appropriately, recognized that "there is not a single business model or cost structure in the CRA market" in deciding that it "does not intend to fix or set up maximum prices". The divergence of business models is, in our view, partly due to the variety of cost factors, and the difficulty of reaching general, cross-industry "cost conclusions" about such factors as "reputational risk" and "investments in new methodologies," among other things. Given the acknowledged complexity and diversity of cost structures in the CRA industry and the purposes of the CRA Regulation, it is necessary and appropriate that ESMA take a less sweeping approach and account for the reality of different CRA business models and fee structures in assessing whether rating fees are "cost-based".

Therefore, we support the approach whereby different business models and fee structures are taken into account when assessing whether fees are cost-based.

Q47: What are your views on the above approach to CRAs' cost-structure? Do you consider other approach or criteria should be applied? If you agree with the above approach, what cost and non-cost components do you consider should be taken into account and periodically reported to ESMA to identify CRAs' fee structure?

As discussed in our introductory remarks, any assessment by ESMA of whether fees are "cost–based" should reflect the statutory context of that phrase (coming, as it does immediately after "non-discriminatory"), EU precedent, and the stated goals and policy concerns behind the CRA Regulation.

As such, ESMA should be concerned with CRA costs only to the extent that cost information may shed light on conflicts, competition or unlawful discrimination concerns. If ESMA identifies an individual or systemic problem with respect to one of these concerns, it can seek cost data if it appears that such information would assist in its inquiry.[2] Accordingly, it is difficult to see the relevance of transaction-specific cost data, including specific cost components, to the identification of potential conflicts, unfair competition or price discrimination issues. Such information is more likely to highlight the complexity of CRA cost structures rather than suggest anticompetitive or otherwise improper behavior by a CRA. Moreover, an effort to allocate costs on an instrument-by-instrument basis would, in effect, transform the Fee Provision into the price cap and fee setting regime disavowed by ESMA.

The CRA industry's complex and diverse cost structure reflects the complex and diverse nature of the capital markets and the instruments CRAs rate. Costs and fees for rating nominally similar transactions within the same asset class may vary significantly due to structural differences between such transactions and the consequent value of the rating to the market. Accordingly, ESMA's proposal to disclose total costs for CRA costs and related cost components, as contemplated in paragraphs 99-101 of the Discussion Paper is more likely to assist ESMA in ensuring that CRA fees are "cost-based," non-discriminatory, and not

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[2] In the European Commission's Impact Assessment Paper the reference to "cost-based" was presented as an objective tool to ensure that prices charged by CRAs are non-discriminatory, suggesting that when the prices charged to different customers for an identical service are similar, there should be no need to affirmatively justify that these prices are "based on costs". Commission Staff Working Paper 'Impact Assessment' accompanying the document proposal for a Regulation amending Regulation (EC° No 1060/2009 on credit rating agencies (2011).

contingent. Meanwhile, given the complexity of CRAs' cost structure and cost variability, paragraph 102 of the Discussion Paper's instrument-by-instrument approach — with an explanation of significant differences between instruments and customers — would be a needlessly and unduly burdensome way of giving effect to the CRA Regulation's policy goals of shedding light on potential conflicts, competition and price discrimination concerns.

Unlike the instrument-by-instrument approach, a more efficient and effective alternative would be for CRAs to provide actual historical fee information by client, or at least a sample thereof, which would enable a review for deviations from applicable fee schedules. CRAs could then provide explanations for relevant deviations.

For the reasons also discussed in our introductory remarks, we query the relevance of reporting information on margins and on specific accounting costs of the type described in paragraph 99 of the Discussion Paper. We do not believe, for example, that a specific amount of energy usage should be of significance in determining compliance with the Fee Provision, if the CRA, whilst considering its overall costs, followed its appropriate fee-setting criteria, policies and practices and thereby ensured that individual clients or product types do not receive improper favorable treatment and that the fees were not set to shut out competitors. We would be concerned that the specific cost data proposed by the Discussion Paper may be more appropriate for assessing whether fees are "cost orientated", which, as already established, the CRA Regulation does not contemplate, rather than whether fees are "cost based" and non-discriminatory.

Q48: Do you agree on identifying average costs per component, average cost per service and average costs per asset class in order to assess whether fees are cost-based?

Given the complexity of the cost structure and the unique nature of each individual transaction, and for the reasons explained in our response to Q47, S&P does not believe the notion of "average cost" is suitable or necessary for determining compliance with the Fee Provision and the legislative intent.

Q49: What is the frequency with which such reporting should be provided to ESMA?

We suggest an annual reporting frequency. The reporting should be limited to that information that reflects the respective CRA's specific business, cost and pricing models and circumstances.

Q50: Particularly to CRAs: what is your current cost and fee structure? What are the relevant costs when issuing a rating? What are the criteria you are applying or plan to apply to demonstrate that fees are based on costs?

S&P's cost structure consists of a wide range of costs. These costs are taken into account in the fees charged by S&P, and effectively reflect the value of ratings to the market. An issue rating on a large, complex transaction may bear greater risk for the CRA, but at the same time, it provides a highly valuable opinion, analysis and transparency to the market. When S&P sets its fees, it must account for the fact that the costs and economic value associated with a given rating may depend not only on the number of analyst hours devoted to assigning the rating but also on other factors such as the size and complexity of the issuance. As discussed above, a narrow and inflexible approach to costs may inhibit innovation and competition among CRAs. Such an approach may also create an artificial dissociation between fees for ratings and their economic value to the market.

S&P's fees are based on fee schedules that are reviewed at least annually for individual practice groups. These fee schedules generally account for a wide range of cost related factors such as the size and complexity of an issuance. S&P takes into account all of the above costs when setting its fees.

In accordance with ESMA's interpretation of the Fee Provision, S&P understands that the Fee Provision requires that cost be *a* factor, not the *sole* or decisive factor, nor a mathematically correlated factor, in determining fees. To comply with the Fee Provision, S&P will continue to

employ policies and procedures that ensure individual clients or product types do not receive improper favorable treatment including the use of:

- Objective pricing criteria which do not discriminate among similarly situated customers and reflect, among other factors, our costs; and
- The use of written, consistently applied, fee schedules for each issuance type.

In addition, fee discussions will continue to be managed by dedicated commercial staff (and hence they will not be visible to ratings analysts), and fee and contractual arrangements will be agreed prior to commencing significant analytical work.

Q51: Do you agree CRAs should periodically report to ESMA on the above list of information? Which frequency do you think it is more appropriate? Do you think any other information should be reported to ESMA?

We refer to our responses to Q47 – Q49 regarding the reporting of cost information referred to in paragraph 104 of the Discussion Paper and our response to Q43 regarding the information on ancillary services and "risk indicators".

We reiterate our concern regarding the cost and non-cost components of S&P's fee structures: As noted in our previous responses, the CRA industry necessarily has a complex and diverse cost structure. Allocating certain costs — such as reputation risk and model and criteria development — to specific ratings is not practical, even if feasible. Consistent with the challenges presented by allocating these more complex costs, the disclosure requirements with respect to allocation should be replaced with a general attestation that costs were considered as a material factor in determining fees. For the reasons described above, costs need not be and should not be mathematically related to fees as such a requirement could lead to unintended consequences, including reduced competition, innovation and greater risks of conflicts of interest (for example, by creating an undue emphasis on the relationship between the time taken by an analyst on a particular rating and the fees charged).

We refer to our response to Q49 regarding the frequency of reporting.

Q52: Do you agree that CRAs should report on an "event-based" basis to ESMA when relevant deviations from their pricing policies occur? Do you agree that CRAs should report on an "event-based" basis to ESMA when ancillary services fees exceed a pre-defined percentage with respect to ratings and follow-up fees?

S&P agrees with the usefulness of "event based" reporting of material breaches of a CRA's pricing and discount policies.

We refer to our responses to our response to Q43 regarding the information on ancillary services.