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| 04 April 2017 |

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| Reply form for the Consultation Paper on Update of the guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation  |
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| Date: 04 April 2017 |

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in Consultation Paper on update of the guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation (CRA), published on the ESMA website.

*Instructions*

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

* use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
* do not remove the tags of type <ESMA\_QUESTION\_CRA\_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
* if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

* if they respond to the question stated;
* contain a clear rationale, including on any related costs and benefits; and
* describe any alternatives that ESMA should consider

**Naming protocol**

In order to facilitate the handling of stakeholders responses please save your document using the following format:

ESMA\_CRA\_NAMEOFCOMPANY\_NAMEOFDOCUMENT.

E.g. if the respondent were XXXX, the name of the reply form would be:

ESMA\_ CRA \_XXXX\_REPLYFORM or

ESMA\_ CRA \_XXXX\_ANNEX1

***Deadline***

Responses must reach us by **03 July 2017.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input/Consultations’.

***Publication of responses***

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

***Data protection***

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the headings ‘Legal notice’ and ‘Data protection’.

# General information about respondent

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| Name of the company / organisation | Bangor University |
| Activity | Audit/Legal/Individual |
| Are you representing an association? |[ ]
| Country/Region | UK |

# Introduction

Please make your introductory comments below, if any:

<ESMA\_COMMENT\_CRA\_1>

Overall, the current consultation could benefit from considering evidence on potential economic or financial benefits from a regulatory change. We do not envisage that the new regime would increase financial stability nor influence the reliability of credit ratings. There are potential unintended consequences e.g. a more onerous compliance hurdle for endorsement would appear to be a barrier to entry for new or expanding CRAs.

Dr Rasha Alsakka and Professor Owain ap Gwilym, Bangor Business School, Bangor University, UK.

<ESMA\_COMMENT\_CRA\_1>

1. Please indicate what you believe will be the impact of ESMA’s change in approach, if any, on the groups of CRAs currently benefiting from the endorsement regime? Please explain your reasoning.

<ESMA\_QUESTION\_CRA\_1>

It is our perception that the current regime of endorsement is straightforward for the large credit rating agencies (CRAs) in terms of compliance. We observe three features of this: (i) only a tiny proportion of issued ratings are ineligible for use in the EU; (ii) the vast majority of ratings are being endorsed (‘EE’) rather than equivalent (‘EQ’); (iii) there has been very little migration in the identifiers applied to ratings since 2012 i.e. very few ‘EE’ identified ratings have become ‘EU’ identified, since there is apparently no incentive for this to happen. Therefore, there has been no meaningful change in the proportion of issued ratings which fall directly within the EU jurisdiction.

The consultation document has perhaps neglected the opportunity to consider research evidence on the broader impact of the regulatory regime in place since 2011. More specifically, it would appear that no consideration has been given to evidence on the role of the current endorsement regime in terms of improving rating quality and/or decreasing mechanistic market reliance on CRAs.

One element of our research investigates the impact of the EU regulatory reforms on European bank ratings assigned by Fitch, Moody’s and S&P. The findings reveal that the new regime led to a significant decrease in rating levels. However, we also find evidence of an increased frequency of false rating warnings caused by unwarranted downgrades. Further, there is some reduction in stock market responsiveness to rating downgrades. Reduced mechanistic reliance on rating signals would be consistent with the aims of the regulatory reforms. We find some evidence of CRAs being protective of their reputations after the passage of the CRA I regulation in 2009. By the time of the establishment of ESMA in 2011 (CRA II), the disciplining effect of the regulation is apparent, and the regulatory update of 2013 (CRA III) has strengthened the existing impact of the regulation.

<ESMA\_QUESTION\_CRA\_1>

1. Please indicate whether you consider the measures which the endorsing CRA should have in place to monitor the conduct of the third-country CRA will adequately ensure the quality and independence of endorsed credit ratings?

<ESMA\_QUESTION\_CRA\_2>

We find this question to be somewhat problematic, in the sense that ESMA has not presented any evidence on the quality and independence of ratings under the current endorsement regime. We are not aware of any publicly available evidence on the performance of the current regime in delivering such objectives. Given that the proposed new regime appears to be more onerous for CRAs, and may lead to some geographical re-alignments for the larger CRAs, one might anticipate costs being passed on to rating users, while no meaningful difference would arise in the rating process nor the quality of ratings.

One element of our research investigates whether ESMA’s 2012 requirement for rating identifiers led to any changes in the information content of sovereign rating actions by Fitch, Moody’s and S&P. We find improvements in the information content of Moody’s rating downgrades, particularly in countries with EE (rather than EU) identifiers, and of Fitch rating downgrades in countries with EE endorsements. However, rating upgrades by S&P for countries with EU issued ratings and by Moody’s for countries with EE endorsements became less informative.

<ESMA\_QUESTION\_CRA\_2>

1. Do you agree with ESMA’s understanding of points (c) and (d) of Article 4(3) of the CRA Regulation?

<ESMA\_QUESTION\_CRA\_3>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CRA\_3>

1. In your view, are there other reasons which could be considered “objective” within the meaning of Article 4(3)(e)? If so please indicate which providing reasons.

<ESMA\_QUESTION\_CRA\_4>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CRA\_4>

1. Do you agree that the endorsing CRA should comply with the general requirements as listed in this section?

<ESMA\_QUESTION\_CRA\_5>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CRA\_5>