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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 | A.M. Best Europe – Rating Services Limited (AMBERS) |
| Activity | Other Financial service providers |
| Are you representing an association? |[ ]
| Country/Region | UK |

# Introduction

Please make your introductory comments below, if any:

<ESMA\_COMMENT\_CRA\_1>

A.M. Best Europe – Rating Services Limited (AMBERS) welcomes the opportunity to provide feedback on ESMA’s Consultation Paper (CP) regarding the proposed update of the guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies (CRA) Regulation.

At a high level, AMBERS has a number of fundamental concerns regarding both the detail of the proposed revisions and the motivation for the changes. AMBERS believes that the current endorsement regime operates effectively for both CRAs and users of ratings within the European Union (EU). For the reasons outlined in this response, the proposals outlined in the CP will serve to undermine the utility of the current regime and will lead to significant additional burdens and costs whilst having limited material benefit.

Before embarking upon such significant changes, AMBERS believes it is imperative that ESMA clearly articulates the basis upon which it believes the existing regime is failing. AMBERS does not believe that the CP provides adequate justification to support the assertion that the existing ESMA endorsement guidelines are failing to deliver the original legislative intention.

AMBERS is hopeful that ESMA will take note of the concerns expressed and will amend the proposals outlined in the CP. However, in the event that ESMA does not make significant changes, AMBERS would stress that it is essential that serious thought is given to the manner in which the transition from the current regime is managed. The number and materiality of changes which will be required to Policies and Procedures to bring endorsed ratings entirely into line with EU requirements is considerable and is not something that can be managed within a short time frame. AMBERS would recommend consideration is given to a “grandfathering” approach whereby existing ratings do not need to comply with the new guidelines for an extended period of time.

Finally, AMBERS believes that ESMA should not be directly concerned with the domicile of a third country CRA but should focus on the regulatory regime under which it operates. So for example post BREXIT in the event that a UK based CRA is then deemed to be in a third country, prior to UK equivalence being confirmed, ratings produced by such CRA (under a global methodology) should be capable of being endorsed into the EU by a subsidiary within the same group by virtue of the UK based CRA's NRSRO status (if it exists), the US being an existing equivalent regime. This would seem to be a pragmatic approach to an issue that might otherwise cause confusion amongst users of ratings, irrespective of whether such a scenario was contemplated by the original regulation. AMBERS notes the position advanced by ESMA in its industry letter dated 27 June 2017 and in particular the statement that “…there is no safeguard that in respect of these ratings all of the requirements of Article 4(3) of the CRAR are fulfilled.” However, as a consequence of being assigned NRSRO status, UK CRAs are required to comply with US regulation and so it is not clear why it is felt that such an arrangement would not provide the same safeguards as exist in respect of ratings issued by a CRA domiciled in the US.

<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>

At the outset, it is important to challenge the assertion implicit in the question that implies that CRAs are the primary beneficiaries of the endorsement regime. In reality the main beneficiaries are the users of ratings within the EU. Whilst AMBERS does not believe that the proposed changes will have any impact on the quality of credit ratings being endorsed into the EU, the administrative burden which will result from the changes proposed by ESMA will be significant.

AMBERS would strongly rebut the comment in paragraph 26 of the CP that this change in approach may have a limited impact on groups of CRAs with global policies and procedures.” In this respect it is important to note the extent to which the EU regulatory regime, especially post CRA 3, is an “outlier” in terms of complexity, the degree of prescriptiveness and the extent to which the legislation goes beyond the IOSCO Code of Conduct. Whilst the A.M. Best Group does operate using a single set of global operating Policies and Procedures, there are specific carve outs to address the more “unique” aspects of the EU Regulation. Whilst the number of differences is comparatively small in number, the materiality of these differences is significant. Moreover, in some instances, the nature of the difference is such we are not actually sure whether the gap can be bridged. We have set out below; a couple of examples of the areas which we feel could be particularly problematic.

1. The concept of a “24 hour rule” is unique to the EU which largely reflects the fact that the origins of this requirement go back to the EU Sovereign Debt Crisis that began in around 2008. The reality is that other jurisdictions are more concerned with issuing ratings as quickly as possible post Rating Committee in order to minimise issues regarding abuses of Inside Information. If AMBERS is required to mandate the 24 hour rule in other jurisdictions it is possible to conceive of situations in which A.M. Best will be breaching local requirements by adhering to the EU standard.
2. Another significant issue results from the high level of prescriptiveness in the EU legislative framework. For example, other jurisdictions will perhaps have a general requirement regarding the communication of confidential information. Within the EU there is then a related requirement to only communicate ratings to certain named individuals which then requires process to monitor and track this. The effect of the change outlined in this paper will be to push this and many other similar requirements into other jurisdictions. This will drive up costs and administrative burdens without, adding any tangible enhancement to the quality of ratings.
3. A further example of material divergence would be in the area of fees. A.M. Best currently provides ratings in over 80 countries worldwide but is unaware of any other CRA legislation outside of the EU that goes anywhere near pricing regulation. Forcing CRAs to roll out EU Pricing Regulation is likely to be extremely problematic.

In addition, to the difficulties of aligning policies and procedures, the other key concern with the proposal relates to the nature and degree of oversight which ESMA have indicated that EU CRAs should perform in respect of endorsed ratings. Further information on this point is contained within Question 2 but at a high level it is likely that the proposals will result in significant additional compliance costs.

<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>

As outlined in the introductory section to this response, AMBERS is not convinced that ESMA have sufficiently made the case that the current approach is leading to poor quality ratings being endorsed into the EU. Consequently, AMBERS believes that the controls it currently has in place are both proportionate and pragmatic. These include, but are not limited to, having visibility of all Compliance monitoring reporting produced by the endorsee’s Compliance function, regular dialogue with counterpart Compliance Officers to discuss emerging issues, full access to relevant regulatory reports and participation at various Group Committees.

AMBERS feels it would be manifestly disproportionate to adopt several of the proposals put forward by ESMA in the CP. For example, the suggestion that the endorsing CRA should perform basic checks of every endorsed credit rating to ensure compliance with key requirements is unworkable. In practice, individual analysts and team leaders are ultimately responsible for ensuring compliance with regulatory requirements. In this sense they are responsible for checking every rating that is issued. The suggestion that there would then be mandatory checking of every single rating to ensure the analyst / team leader had done their job is disproportionate. Any follow up checking has to be sample based in nature. Where this identifies issues, then samples can be extended accordingly. The second key point to make in this space is around the suggestion that it has to be endorsing CRA that performs the oversight. At present, local Quality Assurance functions are responsible for first line testing of compliance with regulatory requirements. The implication of the paper is that endorsing CRAs would be unable to place any reliance upon this QA unless the function was housed with the EU entity.

In practice, AMBERS would not be averse to undertaking additional compliance monitoring in the endorsement space and could, for example, conduct an annual endorsement specific review. This could include reviewing samples of the checks performed by local QA / Compliance functions. It could also be possible to include endorsed ratings in monitoring exercises undertaken by AMBERS as part of its compliance monitoring programme. However, it should be noted that these cases often form part of monitoring reviews undertaken by the endorsee CRA and AMBERS believes it would be entirely appropriate to place reliance on those reviews in its assessment of the adequacy of the endorsement regime.

So in conclusion, AMBERS believes that appropriate oversight of endorsed ratings could include the following activities:

* Access to relevant reports produced by the endorsee CRA (Monitoring / Board Reports etc.)
* Quarterly meeting with endorsee Compliance Officer to discuss issues that may impact the endorsed ratings
* Access to all regulatory inspection reports produced in respect of the endorsee CRA
* Annual review of the adequacy of the endorsement regime to include an assessment of the local QA regime and a sample review of endorsed ratings to ensure adherence to Policies and Procedures (reliance to be placed on any review performed by the endorsee CRA)
* To potentially include endorsed ratings in generic compliance monitoring undertaken by the EU CRA.

<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>

AMBERS has no particular comments regarding ESMA’s understanding of points (c) and (d) of Article 4(3) of the CRA Regulation as outlined in the Consultation Paper.

The only word of caution AMBERS would note is that in some situations, there may be reasons why a CRA is unable to provide certain pieces of information to ESMA due to restrictions imposed by a third country regulator. For example, some regulators across the globe will state that their express permission is required before forwarding an inspection report or findings letter to another regulator. If such consent is not forthcoming, an EU CRA would not be able to comply with ESMA’s request for such information

<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>

In addition, to the example put forward by ESMA, AMBERS would also suggest the following examples:

* In the CP, ESMA state that they consider an “*objective reason” to exist where the rated entity or instrument is established or issued in the third country where the rating is elaborated*.” AMBERS’ would suggest that ESMA expands this example to reflect the fact that the geographic exemption should also apply on a regional basis. For example, AMBERS currently endorses ratings produced by its sister office in Singapore (AMBAPS). As well as rating companies based in Singapore, AMBAPS also provides ratings to countries across the South East Asian Region and in Australasia. Clearly it is not practical for those ratings to be elaborated from the EU.
* AMBERS would also consider that an “objective reason” exists where a non-EU CRA provides a rating to an EU entity where that EU entity is a subsidiary of a wider group where the analysis of the parent is conducted by the third country CRA. Given the consistency of methodology adopted by A.M, Best, such an approach results in no material difference in the rating outcome.
* A third example of an “objective reason” might occur where there is a particular specialisation / expertise within the third country CRA that makes it more appropriate for that rating to be elaborated outside of the EU. For example, it might be that a particular niche type of insurance company is formed in the EU but all of A.M. Best’s previous experience of such ratings is domiciled in, for example, the US office. In order to ensure consistency of approach it may be sensible to conduct the analysis in the US office and then to endorse the rating. It is worth noting that AMBERS does not currently endorse ratings on this basis.

<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>

AMBERS has previously expressed concerns regarding the volume of information provided to ESMA and believes the volume of information it is currently required to provide is disproportionate to the risks it poses. AMBERS would therefore be opposed to any suggestion that the periodic reporting regime needs to be further extended at this time.

<ESMA\_QUESTION\_CRA\_5>