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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 | University of East Anglia/ Norwich Business School |
| Activity | Audit/Legal/Individual |
| Are you representing an association? |[ ]
| Country/Region | UK, Norwich |

# Introduction

Please make your introductory comments below, if any:

<ESMA\_COMMENT\_CRA\_1>

My name is Patrycja Klusak and I am a Lecturer in Banking and Finance at University of East Anglia, Norwich Business School. I hold PhD in Finance from Bangor University, MPhil in Real Estate Finance at Cambridge University and BA in Banking and Finance from Bangor University. My research encompasses empirical investigations related to recently introduced credit rating agency (CRA) regulation and its effects on financial systems, with particular interest in Europe.

Given my background in this topic I hope that I can contribute to this debate and offer my expertise and support. As a way of answering the questions I would like to go through points that captured my utmost interest and where I can share my ideas. If I can help and answer any other questions relating to the endorsement issues please do not hesitate to contact me via e-mail p.klusak@uea.ac.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>

Firstly, it is important to gain an understanding and explore if the endorsement regime works and if it benefits the stakeholders as envisaged by the Article 4 (3). My study with colleagues (Klusak et al., in progress) is the first attempt to empirically test the EU CRA regulation and its impact on the rating industry. Namely, we test whether the ESMA’s requirement for identifiers (from April 2012) led to changes in the quality of ratings assigned by CRAs. We find somewhat mixed results. Some of the CRAs benefit from the endorsement whereas others produce ratings which are of lesser quality than before which can be attributed to the regulation. In the latter case the ratings issued within the EU states tend to be of higher quality than the ones issues in the endorsed countries. We do not yet know the mechanisms behind this but assumedly CRAs themselves could add to this discussion.

Moreover, my results support earlier studies in the top peer reviewed journals conducted in the US using the introduction of the CRA regulation (SEC regulation in 1975 and Dodd Frank Act in 2010). Behr et al. (2016) and Dimitrov et al. (2015) find that ratings are lower quality and/or inflated as a result of the introduced regulations. Therefore, impact of endorsement should be studied a little closer to avoid further unintended consequences.

ESMAS’s change in approach might in fact result in raising regulatory cost to the CRAs and hinder their productivity while raising the costs to the issuers (please see answer to question 2).<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>

In a way of answering this question I would like to focus on two sections, #31b and #33, of the proposal.

With regards to point #31b one has to remember that this additional work imposed upon the endorsing CRA might lessen their incentive to endorse outside ratings and therefore reduce the amount of ratings that are available to investors. This could potentially lead to increases in the cost of capital. Moreover, as could be seen in the recent SEC yearly reports (SEC 2015; 2016) the number of analysts per CRA in comparison to released ratings is on the decrease. Therefore, if the endorsing CRAs continue complying with the regulatory rules the quality of their ratings might be compromised as a result. Opp et al. (2013) suggests that ratings-contingent regulation diminishes the incentives of CRAs for information provision. In other words, CRAs will abide by regulation and release high quality of ratings if their costs do not outweigh the benefits. Alternatively, if CRAs use more human capital to fulfil the regulatory requirements these costs might be then passed on the consumer (i.e. issuers).

Further, section #33 of the document refers to the supervisory responsibilities of the endorsing CRAs. As said before, additional responsibilities might add strain to already busy schedules of analysts who might be under the pressure to complete their own rating tasks and at the same time answer for work of others in the third country CRA. This proposes a question whether there should be any course of action (i.e. penalties) for the endorsing CRAs which do not abide by the

ESMA rules.

References

Behr, P., Kisgen, D., and Taillard, J., 2016, Did government regulations lead to inflated credit ratings? *Management science*. Forthcoming.

Dimitrov, V., Palia, D., and Tang, L., 2015, Impact of the Dodd-Frank Act on credit ratings, *Journal of Financial Economics*, vol. 115, pp. 505-520.

Klusak, P., in progress. The impact of ESMA regulatory identifiers on the quality of ratings.

Opp, C. C., Opp, M. M., and Harris, M., 2013, Rating agencies in the face of regulation, *Journal of Financial Economics*, vol. 108, pp. 46-61.

Securities and Exchange Commission (SEC) 2016, Annual Report on Nationally Recognized Statistical Rating Organization; As required by Section 6 of the Credit Rating Agency Reform Act of 2006, December 2016.

Securities and Exchange Commission (SEC) 2015, Annual Report on Nationally Recognized Statistical Rating Organization; As required by Section 6 of the Credit Rating Agency Reform Act of 2006, December 2015.

<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>