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| 26 March 2018 |

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| Reply form for the Consultation Paper on  The Guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation (CRAR) – proposed supplementary guidance on how to assess if a requirement is “as stringent as” the requirements set out in CRAR |
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| Date: 26 March 2018 |

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Consultation Paper on the Guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation (CRAR) with proposed supplementary guidance on how to assess if a requirement is “as stringent as” the requirements set out in CRAR, 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 **25 May 2018.**

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 |
| 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) of 27 March 2018 which sought to provide supplementary guidance for Credit Rating Agencies (CRA) endorsing ratings into the European Union (EU) on how to assess if a requirement is “as stringent as” the requirements set out in CRAR.

As was outlined by a number of respondents to the earlier consultation exercises regarding the proposed changes to the endorsement regime, there remains a fundamental concern that the changes ESMA is seeking to introduce are inconsistent with the settled interpretation of the law provided by the European Commission. AMBERS shares these concerns and remains of the opinion that the justification for such a severe change of direction has yet to be clearly articulated. In addition, evidence has yet to be provided to clearly demonstrate that the existing endorsement regime is resulting in sub-standard ratings being endorsed into the EU. The Final Report published by ESMA in November 2017 suggests that changes are needed to enhance ESMA’s supervision of endorsed ratings. However, AMBERS does not believe there is any evidence to support the conclusion that there are deficiencies in the existing supervisory regime or that ESMA’s supervisory efforts in respect of endorsed ratings have been hampered by a reluctance of CRAs to provide information in response to a specific request for such information.

In its response to the original CP regarding changes to the endorsement regime, AMBERS stated that it believed the proposals outlined would serve to undermine the utility of the endorsement regime and would lead to significant additional burdens and costs whilst having limited material benefit. At a high level, the proposals outlined in the guidelines published on 27 March 2018 do little to address these concerns. Nevertheless, whilst AMBERS continues to question the validity and benefits of the proposed changes, AMBERS provides below, its responses to the specific questions asked regarding the detail of the proposal.

<ESMA\_COMMENT\_CRA\_1>

1. Do you agree with the proposed guidelines in respect of Paragraph 3c of Section B of Annex I?

<ESMA\_QUESTION\_CRA\_1>

AMBERS disagrees with a number of the assertions that underpin the view outlined by ESMA and in particular the statement that:

“*However, the overall objectives of these provisions, to mitigate conflicts of interests and foster fair competition in the CRA industry, are present in the legislation in force in many other jurisdictions.”*

In A.M. Best’s experience, whilst it is indeed the case that the mitigation of conflicts of interest is a common regulatory objective, it is simply not true to say that other jurisdictions have competition related objectives. A.M. Best currently provides ratings in over 85 countries and the EU legislation is, to the best of our knowledge, the only jurisdiction that has a specific competition objective linked to CRA regulation. The unfortunate reality in other jurisdictions is often that competition is actively discouraged with significant barriers to entry provided for smaller agencies with regulatory agencies unwilling to take on the additional burdens and costs linked with authorising and regulating a large number of market participants.

The existing fee related requirements in other jurisdictions are primarily concerned with seeking to ensure appropriate separation between analytical and commercial functions. These arrangements help to ensure that the fees charged for credit rating services are not dependent upon the level of the rating issued and effectively manage conflicts of interest. However, there is no requirement to ensure fees are linked to cost in any other jurisdiction and no specific competition related objectives. As such the impact of the position outlined by ESMA in the CP will be to mandate that EU Style pricing policies and procedures are introduced into third country regimes. ESMA may be entirely comfortable with this outcome but it is nevertheless important to challenge the suggestion in the CP that this outcome will be consistent with existing regulatory expectations outside of the EU.

Finally, AMBERS notes ESMA’s reference to the Thematic Report on Fees charged by Credit Rating Agencies and Trade Repositories and the comment that this “clarifies how ESMA expects CRAs to interpret the requirements of paragraph 3C of Section B of Annex I of CRAR. AMBERs would note that the thematic report provides only limited additional clarity at this time.

<ESMA\_QUESTION\_CRA\_1>

1. Do you agree with the proposed guidelines in respect of Article 11(3) and Point 2 of Part II of Section E of Annex I and the Delegated Regulation on Fees?

<ESMA\_QUESTION\_CRA\_2>

At a high level, AMBERS has concerns with the volume of reporting currently required by ESMA. The existing reporting regime is disproportionate to the risks posed by smaller to medium sized CRAs and AMBERS firmly believes that the same regulatory outcomes could be achieved with a far more streamlined and targeted approach. AMBERS looks forward to making further representations on these points as part of the proposed revision to the Periodic Guidelines which is scheduled to take place later in 2018.

Against this background, AMBERS has concerns with the additional burden which the reporting of endorsed fees will impose. Nevertheless, AMBERS notes the suggestion that CRAs would only need to report fees that deviated from documented pricing policies and procedures (assuming those procedures appropriately reflected the EU requirements around costs).

<ESMA\_QUESTION\_CRA\_2>

1. Do you agree with the proposed guidelines in respect of Article 10(3)?

<ESMA\_QUESTION\_CRA\_3>

AMBERS does not currently issue ratings on Structured Finance Instruments (SFI) and so has no comments on the proposals.

<ESMA\_QUESTION\_CRA\_3>

1. Do you agree with the proposed guidelines in respect of Article 10(5)?

<ESMA\_QUESTION\_CRA\_4>

AMBERS does not currently issue unsolicited ratings and so has no comments on the proposals.

<ESMA\_QUESTION\_CRA\_4>

1. Do you agree with the proposed guidelines in respect of Article 12 and Part III of Section E of Annex I?

<ESMA\_QUESTION\_CRA\_5>

AMBERS believes that the proposals to extend the range of information contained within the Transparency Report (TR) to include additional information relating to endorsed ratings will add additional costs and complexity into the production of the TR whilst doing very little to promote greater transparency. However, these concerns are primarily related to the limitations of the Transparency Report process itself as opposed to the specific proposals in the CP.

<ESMA\_QUESTION\_CRA\_5>

1. Do you agree with the proposed guidelines in respect of Paragraph 6 of Subsection I of Section D of Annex I?

<ESMA\_QUESTION\_CRA\_6>

AMBERS notes and welcomes ESMA’s confirmation that there will not be a requirement to report details of initial or preliminary ratings in respect of endorsed ratings. However, further guidance as to the additional actions which CRAs could take to prevent rating shopping would be appreciated.

<ESMA\_QUESTION\_CRA\_6>

1. Do you agree with the proposed guidelines in respect of Article 8(3), (5), (5a) and (6)?

<ESMA\_QUESTION\_CRA\_7>

AMBERS follows a single global methodology and so has no comments on ESMA’s proposals regarding the above Articles.

<ESMA\_QUESTION\_CRA\_7>

1. Do you agree with the proposed guidelines in respect of Article 8(7)(a)?

<ESMA\_QUESTION\_CRA\_8>

AMBERS has no comments on ESMA’s proposals regarding the above Article.

<ESMA\_QUESTION\_CRA\_8>

1. Do you agree with the proposed guidelines in respect of Article 7(4) and Paragraph 8 of Section C of Annex I?

<ESMA\_QUESTION\_CRA\_9>

AMBERS notes and welcomes ESMA’s proposals which appear to suggest a degree of flexibility around the requirement to rotate lead analysts, rating analysts and persons approving credit ratings. A.M. Best will reflect on whether any changes are required to existing Policies and Procedures prior to the new guidelines taking effect in January 2019.

<ESMA\_QUESTION\_CRA\_9>

1. Do you agree with the proposed guidelines in respect of Article 6(1) and Paragraph 3(aa) and (ca) of Section B of Annex I?

<ESMA\_QUESTION\_CRA\_10>

AMBERS has no comments on ESMA’s proposals regarding conflicts of interest relating to shareholders and directors of CRAs.

<ESMA\_QUESTION\_CRA\_10>

1. Do you agree with the proposed guidelines in respect of Paragraphs (6)-(7) of Section C of Annex I?

<ESMA\_QUESTION\_CRA\_11>

AMBERS notes the proposals outlined by ESMA. With respect to Look-Back Reviews (LBR) where an analyst leaves the employment of a CRA, there are already robust policies and procedures in this area. As the CP notes, the main area of divergence is around the time period considered as part of the LBR. The impact of the proposals is likely to be a need for A.M. Best to “top up” its global policies to meet EU requirements.

On a more practical level, AMBERS has concerns regarding the suggestion that it should now extend the requirements of paragraph 7 of Section C of Annex I to non-EU employees. Indeed, further work will be required to understand whether such an extension would be consistent with Employment Law in third countries. Furthermore, in practice, this requirement is primarily incumbent upon the individual employee as there is little, if anything, a CRA can do to physically prevent an employee from joining another entity. The ability of EU authorities to impose this requirement on non-EU citizens in third country regimes would appear questionable.

In essence this requirement is seeking to ensure that CRAs identify and manage conflicts of interest relating to employment transitions. AMBERS believes this outcome is achieved by the existing controls that have been implemented across the Group. At a high level, these controls include:

* Requiring Rating Analysts to immediately notify their immediate supervisor if they are leaving to join a Rated Entity. In addition, even when an employee has left A.M. Best there is a requirement on all existing staff to notify their supervisor if they become aware that a former employee has joined a Rated Company
* The requirement to conduct a LBR where an employee has joined a Rated entity where they were involved in the rating of that company. This will include conducting an Event Driven Rating Committee within a prescribed time frame that considers whether there was any evidence the rating was unduly influenced by the former employee’s participation. There is then a requirement to either revise or affirm the rating. Prior to the RC, a review will take place of communications between the former employee and the entity to which the rating relates. A summary of this review is provided to the RC.
* The subsequent rating disclosure for the event driven rating (or being placed under review if it is not possible to complete that review within a prescribed time frame) must explain that the update is a result of the participation of a former Rating Analyst in a previous rating action related to their current employer.

In AMBERS’ opinion, the above controls effectively achieve the same outcome of appropriately managing conflicts of interest resulting from employment transitions.

<ESMA\_QUESTION\_CRA\_11>

1. Do you agree with the proposed guidelines in respect of Article 10(2) and Paragraph 3 of Subsection I of Section D of Annex I?

<ESMA\_QUESTION\_CRA\_12>

AMBERS notes ESMA’s comments in respect of the potential extension of the 24 hour rule to third country jurisdictions and in particular notes the suggestion that steps could be considered “as stringent as” where:

* The CRA notifies a rated entity about a rating action in advance of the publication
* During the business hours of the rated entity
* Provides the rated entity with a reasonable amount of time to provide feedback on any material errors.

In practice, A.M. Best is generally comfortable with the concept of providing clients with the opportunity to provide feedback on any material errors prior to publication. However, concerns remain regarding exceptional situations where the requirements of third country regulators to release Market Sensitive information as quickly as possible could contradict ESMA’s expectations. The concern is perhaps most clearly articulated in the context of a Merger or Acquisition scenario whereby a CRA is under pressure to issue a rating update as soon as possible in order to address third country regulatory regime requirements not to suppress potentially market sensitive information. That rating update could involve seeking to make notifications to numerous rating contacts in multiple jurisdictions / time zones. A.M. Best can strive to make contact during working hours and provide significant time for a response but the reality is that this may not always be possible. It may be necessary to speak / contact a rating contact out of their “normal business hours” and it may be that the time frame for providing feedback is tight. AMBERS would suggest a more pragmatic approach would be to conclude that the “as stringent as” test is met where the CRA notifies the rated entity about a rating action in advance of the publication and provides them with a reasonable opportunity to provide feedback on material errors.

<ESMA\_QUESTION\_CRA\_12>

1. Do you agree with the proposed guidelines in respect of Article 10(2a)?

<ESMA\_QUESTION\_CRA\_13>

AMBERS has no comments on ESMA’s proposals regarding Inside Information.

<ESMA\_QUESTION\_CRA\_13>

1. Do you agree with the proposed guidelines in respect of Article 7(3) and Paragraph 3 of Section C of Annex I?

<ESMA\_QUESTION\_CRA\_14>

AMBERS has no comments on ESMA’s proposals regarding the protection of confidential information.

<ESMA\_QUESTION\_CRA\_14>

1. Do you agree with the proposed guidelines in respect of Article 6(2) and Paragraphs 7-9 of Section B of Annex I?

<ESMA\_QUESTION\_CRA\_15>

AMBERS has no new comments on the proposals to mandate that records relating to endorsed ratings are maintained for five years as per the EU requirement.

<ESMA\_QUESTION\_CRA\_15>

1. Have you identified any alternatives internal requirements which could meet the same objective and effects of an EU requirement in practice?

<ESMA\_QUESTION\_CRA\_16>

AMBERS has no additional suggestions as alternative internal requirements which could meet the same objective and effects of an EU requirement in practice.

<ESMA\_QUESTION\_CRA\_16>