Date: 22 May 2014
ESMA/2014/SMSG/018

ADVICE TO ESMA

Call for evidence: Competition, choice and conflicts of interest in the credit rating industry

Executive Summary

I. The objective of this paper is to provide advice to the European Securities and Markets Authority on its call for evidence into Competition, choice and conflicts of interest in the credit rating industry.

II. The SMSG very much welcomes the opportunity to examine the effectiveness of measures taken to date to further competition among credit rating agencies, as well as to consider what additional steps, may be needed to bring about an effective functioning market for the provision of credit ratings.

III. The SMSG is not in a position to provide specific evidence as a user of credit ratings so we will offer a high level view of the issue as we see it. We expand on what we believe to be the keys issues in more depth below but the SMSG would like to highlight four points which we believe the Joint Committee must take into consideration when it considers the technical advice it will submit to the European Commission in due course:

IV. First, any discussion on Credit Rating Agencies must be set in the context of the dominance of the three main credit ratings agencies. The market share of these three companies was >90% according to ESMA in December 2014. Indeed the combined market share of the three had increased by 3% from that recorded at December 2013.

V. Second, while the SMSG acknowledges that the timing of this review is not of ESMA's choosing, we feel strongly that it is too early to consider removing any statutory measures (CRA3, **462/2013**) introduced to promote competition in the CRA industry. Many of these measures, including imposing a second rating agency on providers, are only just bedding in and so any assessment of their effectiveness is premature.

VI. Finally, the SMSG believes this call for evidence has to be viewed in the wider context of the Commission's regulatory ambitions; and specifically its programme for Capital Markets Union. As the SMSG response to CMU (2015/SMSG/017 PART I) makes clear if CMU is to be achieved then greater diversity in credit rating providers will be an essential underpinning component.

VIII. Market share

The SMSG is concerned about the lack of meaningful competition in the credit ratings industry. We question how parties seeking a rating can find a genuine choice of providers with just three CRAs accounting for in excess of 90% of the entire market. Indeed the continuing domination of the CRA market by such a small group of providers is a textbook example of a non-functioning market.

IX. We are supportive of the reforms introduced (CRA3) to try and foster new and niche credit ratings providers. However we believe that many of these measures, have yet to have had time to take effect. In particular the transparency measures will not become apparent until the launch of the European Ratings Platform (June 2015).

X. It will only be at this point that those seeking to compare outcomes of ratings as well as the prices charged by rating agencies will have a genuine opportunity to make comparisons.

XI. The SMSG sees different possible uses of the European Rating Platform. These uses could increase the visibility of smaller, niche rating agencies while at the same time reducing the mechanistic reliance on ratings. First of all, if all ratings of a given issue/issuer were available on a common public platform, this would enable users to identify outliers among the ratings and encourage them to dig deeper. Digging deeper would mean not mechanistically relying on the rating itself but rather ordering the full study of that rating agency and /or supplementing the ratings by an internal credit assessment.

XII. Secondly, signals of deteriorating (or improving) credit quality would be spotted at an earlier stage as it quite likely that one or more rating agencies are quicker than others in adjusting their ratings. This could encourage user of ratings to order the full study of the rating agency which adjusted its ratings and/or supplement the ratings by an internal credit assessment.

XIII. Thirdly, it would increase the visibility of smaller niche rating agencies, which focus on a particular segment or a particular regional market. This in turn would be beneficial to objective of creating a CMU.

XIV. However, during the proceedings of the WG, a particular practical point of attention was raised. It is pivotal that the European Rating Platform can be consulted in a user-friendly way. It would be prohibitively time-consuming, especially for fund managers, if rating information would have to be queried each issue/issuer separately. For this reason, it is required that a functionality be developed where users could query the Rating Platform by uploading sets of codes (examples ISIN for an issue or Legal Entity Identifier for an issuer).

XV. For these reasons we would not support any measure to roll back the provisions of Articles 8c and d of the Regulation 462/2013. Indeed the SMSG argued for an extension of this requirement to get a second rating from a CRA with less than 10% market share to all ratings not just those for structure products in its response to the (2015/SMSG/011).

XVI. Likewise the SMSG would not wish to see the requirement to rotate ratings providers on structured products withdrawn at this time.

XVII. The SMSG is also concerned that the EBA proposals in its Consultation Paper on ITS on Mapping of ECAIs Credit Assessments (EBA/CP/2015/08) could have the unintended consequence of increasing the reliance on credit ratings from one of the big three providers. While the SMSG is supportive of the aims of the Consultation Paper we do not think that these should be achieved at the expense of furthering competition and choice in the credit ratings market.

XVIII. Capital Markets Union

In its response to the European Commission CMU consultation (2015-SMSG 017) the SMSG noted that a credit rating is often a requirement for SMEs in order for them to gain access to capital markets. It follows therefore that given the Commissions stated objective of expanding access to the capital markets for SME that steps will have to be taken in-tandem to ensure there are sufficient ratings providers to cope with this anticipated demand.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

Adopted on 22 May 2015

Jesper Lau Hansen
Chair
Securities and Markets Stakeholder Group