Call for evidence

on the assessment of compliance of credit rating agencies with Article 8.3 of the Credit Rating Agencies Regulation (1060/2009/EC)

26 May 2011 | ESMA/2011/155

European Securities and Markets Authority

Date: 26 May 2011
ESMA/2011/155

Table of Contents

I. Executive summary

In the light of the agreed amendments to the Credit Rating Agencies Regulation (EC) No 1060/2009 (CRA Regulation), ESMA is mindful of its mandate to produce draft regulatory technical standards (RTS) for adoption by the Commission. This Call for Evidence concerns RTS on the assessment of compliance of credit rating methodologies with the requirements set out in Article 8(3).

The aim of this Call for Evidence is for ESMA to gather information from credit rating agencies (CRAs) and other interested parties in preparing the public consultation paper on the RTS and the analysis of the potential related costs and benefits, as required by Article 10 of the ESMA Regulation No.1095/2010/EU.

ESMA invites responses to the questions set out in this Call for Evidence by **20/06/2011** via ESMA's website (www.esma.europa.eu) under the section "ESMA Work" and "Consultation".

All contributions received will be published following this date, unless respondents request their submission be treated as confidential.

II Background

1. Article 8(3) of the CRA Regulation provides that "a credit rating agency shall use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing".

2. As required by Article 21(3)(b) of the CRA Regulation (prior to its amendment), CESR issued guidance in August 2010 on common standards for assessment of compliance of credit rating methodologies with the requirements set out in Article 8(3) (CESR/Ref. 10-945, CESR Guidance).

3. The CESR Guidance primarily sets out the typical information that competent authorities expect to receive from CRAs in order to assess the compliance of credit rating methodologies in accordance with their ongoing supervisory responsibilities under the CRA Regulation. The Guidance was made following a public consultation conducted by CESR.

4. The amendments to the CRA Regulation recast Article 21(3)(b) as a new Article 21(4)(d). This provides a mandate for ESMA to produce draft RTS on the assessment of compliance of credit rating methodologies with Article 8(3) for endorsement by the Commission.

5. According to Article 10 (1) of the ESMA Regulation (1095/2010/EU), the RTS shall be technical, shall not imply strategic decisions or policy choices and their content shall be delimited by the legislative acts on which they are based. ESMA is required to conduct open public consultations on the draft RTS and analyse the potential related costs and benefits.

6. Accordingly, in developing the RTS, ESMA is seeking market input to enhance its understanding of the operation and impact of Article 8(3). It is also seeking input on the possible incremental costs to the industry of potential regulatory requirements in relation to implementing the RTS. The responses received will help inform ESMA's cost benefit analysis and public consultation paper.

7. In developing the RTS, ESMA should consider and, if appropriate and necessary, update the CESR Guidance.

8. According to the agreed amendments to the CRA Regulation and without prejudice to Article 23, ESMA shall examine regularly compliance with Article 8(3) and in the framework of this examination it shall (a) verify the execution of back-testing by CRAs, (b) analyse the results of that back-testing and (c) verify that the CRAs have processes in place to take into account the results of the back-testing in their rating methodologies.

9. Note that ESMA is prohibited from interfering with the content of credit ratings or methodologies by Article 23(1) and will ensure that this Article is complied with when developing the RTS.

III Questions

When answering the following questions, please ensure that any reference to costs is quantified (in Euros) where possible.

1. Please indicate (i) the name of your organisation; (ii) your annual revenues (from the most recent annual report); (iii) the nature of your business (e.g. CRA, association, etc); and (iv) your areas of specialisation (e.g. corporates, structured finance, financial institutions, insurance).

1. Questions for CRAs - Direct costs and benefits to the CRA

If you are not a CRA, please proceed to Part 2 below.

2. Has compliance with Article 8(3) resulted in changes to your business practice? To the extent possible please quantify any costs and benefits.

3. Which of the guidelines within the CESR Guidance are you already implementing on an ongoing basis as part of the registration process?

For Q4 to Q6, please specify which elements of the standards embodied in the CESR Guidance will be the most burdensome to implement and provide reasons.

4. For each element identified as not currently implemented in Q3(a), please specify:

   a. The expected costs of implementation (one-off costs vs. ongoing costs)? Please complete Table 1 when answering this question.

Table 1: Expected costs (in EUR)

Cost \ Nature of cost	One off cost	Ongoing cost (per annum)
Staff (e.g. hiring, training)		
Legal		
IT (e.g. development, systems)		
Other costs - Please specify: ______ ______		

b. Please state if you consider there are other non-monetised costs (e.g. potential operational risks, increased reputational risk etc.).

5. Please state whether you consider there are any benefits from the standards embodied in the CESR Guidance for your organisation, for example:

   a. Through reputational improvements resulting from improved accountability of credit rating methodologies;

   b. Improvements to the process of producing and monitoring ratings methodologies; or

   c. Improvements to the quality of credit ratings.

Please quantify these benefits where possible.

6. Will the standards embodied in the CESR Guidance, if transposed to RTS, result in changes to your business model or operation (e.g. changes to ratings development and innovation, hampering of new business lines or closure of existing business lines etc.)? Please provide details and quantify any costs and benefits.

2. Questions for all stakeholders

7. What do you consider to be the most important factors within a credit rating methodology to ensure that it is:

   a. rigorous;
   b. systematic;
   c. continuous; and
   d. subject to validation based on historical experience, including back-testing?

Please provide as much detail as possible, including reasons, and please list each factor by reference to each requirement.

8. In relation to each of the factors identified in Q7, is there a factor that is not covered in the standards embodied in the CESR Guidance published on 30 August 2010? If so, please provide reasons as to why that factor should be included in the RTS.

9. Are there any factors covered in the standards embodied in the CESR Guidance that you do not consider to be important? Please identify factors and provide reasons.

10. Do you consider that the requirements of Article 8(3) could be met without implementing any of the standards embodied in the CESR Guidance? If so, do you consider this would result in a greater or lower efficiency for CRAs and/or stakeholders? Please provide details. If there are less burdensome alternatives that would secure equivalent effects, please describe them.

11. What factors, if any, might be relevant to ESMA in determining whether the frequency of assessment should be more or less frequent? For example, the CEBS "Revised Guidelines on the recognition of External Credit Assessment Institutions" published on 30 November 2010 suggests the level of assessment could be reduced for a rating methodology which is supported by quantifiable evidence of producing robust credit ratings.

12. Do you expect any of the standards embodied in the CESR Guidance, if transposed to RTS, to have any impact on existing or future credit ratings? If so, please specify which type(s) of rating (e.g. corporate, structured finance, financial institution, insurance, sovereign ratings) and what the impact(s) will be. Please specify how the impact will occur and allocate the impact to each standard embodied within the CESR Guidance.

13. Will the standards embodied in the CESR Guidance, if transposed to RTS, have an impact on market size, market structure and your position in the markets within which you operate? Specifically, do you expect:

    a. Markets to grow, shrink or to remain unaffected? Please specify and explain.
    b. Your competitive position to be enhanced or weakened? If so, please elaborate.
    c. The introduction of prohibitive barriers to entry to new CRAs? If so, please elaborate.
    d. Disproportionate impacts (e.g. market exit) on smaller or local CRAs? If so, please elaborate.

14. What costs or benefits do you expect the standards embodied in the CESR Guidance, if transposed to RTS, to have on financial markets or the wider economy, for example, through:

    a. Changes to regulatory capital holdings?
    b. Effects on the price of raising capital?
    c. Improvements in mitigating risks to the financial system?
    d. Using credit ratings of better quality?

15. Do you expect any other cost(s), benefit(s) and/or impact(s) that are not covered in these questions? If so, please specify.