EACRA

POSITION PAPER

EUROPEAN ASSOCIATION OF CREDIT RATING AGENCIES

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Reference: ECB criteria for acceptance of Credit Rating Agencies as ECAI sources for ECAF purposes

On January 2016, the European Central Bank published "minimum coverage requirements for ECAIs in the European Credit Assessment Framework ("ECAF")[1]. In addition to the general requirement that Credit Rating Agencies ("CRAs") be registered or certified in accordance with Regulation 1060/2009 on CRAs with the European Securities and Markets Authority ("ESMA") introduced in 2013, the new criteria for CRAs includes the following elements:

- Coverage of at least 3 out of the following 4 segments: uncovered bank bonds, corporate bonds, covered bonds and ABS. Additionally, the ECAF requests Sovereign ratings on Euro-area countries where assets are located.
- Coverage of at least of 20% of outstanding eligible debt volumes in respective asset classes. This corresponds to a minimum of EUR 700 Bill of eligible assets.
- Coverage of at least 10% of rated entities
- Coverage of at least of 2/3 of Euro-area Member States.
- Historic track record of at least 3 years.

With the adoption of the CRD IV package in 2013, European Policy Makers have opted to increase competition in the rating market by grating automatic recognition of Credit Rating Agencies as External Credit Assessments Institutions (ECAIs). In addition, European Policy Makers have called on the ECB to extend the list of ECAIs for ECAF purposes:

> "The ESCB central banks, without making the process easier or less demanding, should provide for the recognition of more credit rating agencies as ECAIs as a way to open the market to other players" (Recital 98 of the CRD IV Regulation)

Our concern is that the minimum coverage requirements on ECAIs defined by the ECB does away with this recital and actively creates a two-tier system of Credit Rating Agencies in Europe, establishing barriers that have the effect of stifling competition in the rating market for the foreseeable future. The above requirements effectively means that no European CRA is currently eligible for ECAF purposes and is unlikely to become available in the medium term to long term, without substantial upfront investments. In our view, the cross-country and cross-market approach that has been outlined, only acts to further cement the existing oligopolistic market structure by introducing insurmountable barriers-to-entry for the High-Grade asset class that currently makes up the bulk of the market.

[1] The detailed requirements are available following this link: http://www.ecb.europa.eu/paym/coll/risk/pdf/minimum_coverage_requirements201601.en.pdf

The ECB argues that these minimum requirements are linked to an efficient implementation of the ECAF:

- The wide cross-market segment coverage extends the due diligence time by the ECB as each of these segments have different risk drivers. This cross-segment requirement excludes from ECAF recognition specialized Credit Rating Agencies focusing their expertise on one or two market segment only, where we believe that their presence could be very valuable to the ECAF. Enticing specialized CRA´s to enter new rating areas where they do not have an expertise to access ECAF, could have perverse effects.
  We note that ICAS focus on one market segment only (usually the non-financial corporates of the respective country, with the exemption of Ireland, where mortgaged-backed promissory notes are assessed).
- With respect the coverage of several Euro-area Member States, we note the same expertise arguments as cross market segment requirements. Additionally, differences in national legislations exist in several areas. More importantly, the ECB requires from CRAs a wider coverage than other sources to the ECAF (such as ICAS or Rating Tools), where the coverage of one Euro-area Member State is accepted. We note that many newer players are making a strong effort to increase coverage in one or two countries to gain access to ECAF, but are not necessarily interested in expanding into other jurisdictions, where their competitive advantage may not be as strong. The ECAF therefore introduces for ECAIs requirements which are not applied to other accepted sources for the ECAF.
- We note that the minimum coverage is defined against eligible debt volumes outstanding, the threshold being set at 20%. Given that new debt issuance amounts to approx 5 to 10% of outstanding debt volumes, CRAs would need to rate nearly all new issuance during several years to achieve this minimum volume requirement. Given the current market structure and dynamic, no one specific (small) European CRA has the ability to access the market share requirements, especially on a paid basis – instead, European CRAs will be obliged to issue unsolicited credit ratings (often based only on publicly available information), on a massive scale just to meet that requirement, with the hope of being ECAF accepted in the longer term. At the time, we do not believe that this is an effort that can be funded by a private initiative, due to the cost of the resources required and the lack of current interest by the market of paying for a rating not accepted by ECAF.

Instead of the cross-country, cross-segment wide coverage and along the same terms applied to other sources accepted by the ECAF, we propose that the ECB should recognize the effort that is been made by market participants in their particular jurisdictions and areas of expertise, by taking a more proportionate approach on CRAs by allowing CRA´s that cover a particular market segment in any of the Euro-Area member State access the ECAF – recognizing that the ECB would grant recognition to CRAs selectively in terms of segments and countries, this being disclosed to market participants.

At this point, we would like to note that the European Court of Auditors recently discussed the existing barriers that hinder the market access for non-systemic CRAs in Special Report no 22/2015. In this sense, the ECB answered the report by stating that the ECAF status would only be a small factor affecting market access, but what we have seen in our daily activities, is that it is the most important factor and therefore are deeply concerned about the

ECB not recognizing the crucial importance of the ECAF-Status for institutional issuers in particular. Since these are the mandates needed by CRAs to meet the ECAF requirements, CRAs find themselves in a vicious circle, where they do not get mandates because they are not ECAF and are not ECAF because they do not get mandates.
We also believe that the ECB should delete the minimum threshold for debt volume outstanding. By doing so, the ECB would take away a requirement we believe is not achievable by newer players in the medium term and does not take into account assets currently rated exclusively (at least on a portfolio basis) by European CRAs, such as mid-caps stock listed companies. Furthermore, the ECB should consider the market acceptance and recognition of a CRA with local issuers and investors (respectively in the areas were the CRA is active).

Such revised ECAF criteria would gradually extend the ECAI status to other CRAs, thereby contributing to more competition in the rating market.

About EACRA

The European Association of Credit Rating Agencies ("EACRA"), registered in Paris, was established in November 2009. The Members of the Association currently originate from 12 countries and include the following companies:

ESMA registered Credit Rating Agencies

A.M. Best Europe - Rating services Limited (AMBERS) is a subsidiary of A.M. Best Inc who have been providing ratings to the Insurance Sector since 1899. AMBERS' rating coverage includes regional, national and global insurers located throughout Europe, the Middle East and Africa.

ARC Ratings is an international rating agency with a presence in 11 countries on four continents. ARC is registered with ESMA and results from a partnership of 5 leading rating agencies operating in India, Brazil, Sub-Saharan Africa, Malaysia and Europe. This partnership has over 6000 rating clients and 400 ratings staff, giving ARC global coverage as well as vital local knowledge

Assekurata Assekuranz Rating-Agentur is the first independent German rating agency that has specialized on the quality evaluation of insurance companies

Axesor: The first Spanish Rating agency registered with ESMA. Specialized in the middle market segment, with ample coverage of the Spanish corporate market.

Capital Intelligence (CI) offers independent rating opinions on financial institutions, corporates and governments in a wide range of countries, especially the emerging markets of Asia, Europe and the Middle East.

Cerved Rating Agency: Italian Credit Rating Agency recognized ECAI by Bank of Italy

Creditreform Rating: based in Germany, a company of the Creditreform Group that is European market leader in the sector of business information was founded 2000 and is specialised in ratings of companies, bonds, funds and structured finance products across Europe.

CRIF: International Credit Rating Agency based in Italy providing both solicited and unsolicited Corporate ratings.

Dagong Europe Credit Rating, headquartered in Milan, was registered by ESMA in June 2013. It is owned by Dagong Global Credit Rating. Dagong Europe provides European and Asian investors with credit opinions on financial institutions (including insurance companies) and non-financial corporate.

Euler Hermes Rating is a European rating agency located in Hamburg, Germany. We offer credit ratings and research about debt capital market instruments of corporates of all sorts of industries, project finance ratings and credit portfolios. Euler Hermes Rating is a member of Euler Hermes Group and a company of Allianz

Scope Ratings is an independent credit rating agency founded in Berlin, Germany, in 2002. The company is specialized in ratings and analysis of corporate bonds, financial institutions, structured finance, and alternative investment funds (AIF).

ESMA certified Credit Rating Agencies

Egan-Jones Ratings Company ("EJR") is a leading Rating Agency in the United States with a strong track record for being early and correct. We publish several hundred qualitative and quantitative reports each month. Our reports are not just maintenance but focus on locating and reporting on active situations. EJR's track record is very compelling as we have shown an exceptional record for anticipating the direction of future credit action.

Kroll Bond Rating Agency (KBRA) was established in an effort to restore trust in credit ratings by creating new standards for assessing risk and by offering accurate, clear and transparent ratings. KBRA is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (NRSRO). In addition, KBRA is recognized by the National Association of Insurance Commissioners (NAIC) as a Credit Rating Provider (CRP).

CRAs registered or recognized according to national legislation outside of the European Union

Credit Rating Agency (CRA) Limited operates in Zambia and is licensed by the Securities and Exchange Commission of Zambia. It commenced operations in September 2014 and is the first active credit rating service provider in Zambia. CRA rates private and public sector entities, and debt instruments.

Fedafin AG : is registered with the Swiss Financial Markets Authority and acts as rating provider to the Swiss stock exchange

JCR Eurasia is an international credit rating institution based in Turkey.

National Rating Agency (NRA) is one of the leading independent rating agencies in Russia. As of today National Rating Agency has assigned ratings to over 750 leading Russian and international companies.

RusRating is a credit rating agency based in Moscow, with sister agencies in Armenia and Kazakhstan. It is accredited with the Ministry of Finance of the Russian Federation.

Other EACRA members

Ellisphere: French leader in business & marketing information and credit management solutions, providing a large range of tools and solutions to secure companies' supply chain financing and improve their development.

Informa is the Marketing, Financial and Business Information leading company in Spain, offering currently more than 3.7 million online scores on Spanish companies

The Members of the Association have very different business models (issuer-pays, investor-pays, hybrid and special models) while assigning ratings. Since January 2014, all ESMA registered or certified CRAs are considered ECAIs across the whole European Economic Area.
Reference the Article 8 d on the use of multiple CRAs and ESMA's report dated December 18th , 2015, all EACRA members registered with ESMA have less than 10% market share in the EU (measured against revenues).