October 30, 2014

European Securities and Markets Authority (ESMA)
103 rue de Grenelle
75345 Paris
France
Submitted online: www.esma.europa.eu

Re: Consultation Paper on periodic information to be submitted to ESMA by Credit Rating Agencies (Consultation Paper)

Dear ESMA:

DBRS welcomes the opportunity to comment on the Consultation Paper which seeks views on new supervisory guidelines for additional information that would be periodically submitted to ESMA by Credit Rating Agencies (CRAs). The additional information focuses on what ESMA considers to be key areas of risk in the CRA sector, namely i) business strategy and senior management ii) the control functions and iii) IT systems and processes. The CP also proposes more information on the detail that should be provided in the submission of information on financial revenues and costs, changes in key positions and staff turnover. And the proposed guidelines propose to incorporate all periodic information that ESMA would like to receive and replace current ESMA Guidelines on Enforcement.

The CRA Regulation requires the registration of CRAs which distribute ratings publicly or by subscription. The cost of mandatory registration and ongoing compliance is substantial for all CRAs, but especially for newer and smaller CRAs. While DBRS appreciates ESMA’s obligation to supervise and the need for information to assist in that obligation, DBRS would argue that the collective set of information and reporting by CRAs required under the current rules and guidelines, the upcoming RTS and this CP is becoming overwhelming and will make it increasingly difficult for CRAs to comply. In short, ESMA’s objective of improving its own supervision poses the unintended risk or consequence of negatively impacting the compliance efforts of the CRAs it supervises. And where the compliance burden becomes too heavy threatens the survival of newer and smaller CRAs.

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1 DBRS is a global credit rating agency consisting of three affiliated companies: DBRS Limited (Canada), DBRS, Inc. (U.S.) and DBRS Ratings Limited (Europe).

2 The guidelines are proposed under Article 16 of EU No 1095/2010 of the European Parliament and of the Council of 24 November 2010, which enables ESMA to publish guidelines addressed to financial market participants with a view to establishing consistent, efficient and effective supervisory practices. These proposed guidelines will replace CESR’s Guidance on the enforcement practices and activities to be conducted under Article 21.3(a) of the Regulation (ESMA/2010/944) of 30 August 2010.

3 Regulation (EU) No 462/2013 (CRA 3 Regulation or CRA3) amending the Regulation (EC) No 1060/2009 on credit rating agencies (CRA1) and Regulation (EU) No 513/2011(CRA2), collectively, the CRA Regulation.

4 CRA3 includes three Regulatory Technical Standards (RTS), two of which will require additional reporting and new systems requirements by CRAs: European Ratings Platform and Fees charged by CRAs to their clients. The other RTS regards disclosure on structured finance instruments by the issuer, originator or sponsor.
Investors benefit from a wide range of rating opinions from CRAs of all shapes and sizes. Indeed, the CRA Regulation encourages diversity and competition within the CRA industry through measures introduced in the last round of regulation. A more diverse CRA industry reduces market volatility from too much reliance on a few CRAs, and increases market safety and soundness for investors. As such, ESMA also has a supervisory responsibility for balanced and proportional requests to CRAs.

It is with these concerns in mind that DBRS provides the following comments on the CP.

*Information to be contained in periodic submissions to ESMA*

DBRS understands that good quality, relevant and timely data assists in supervision. However, certain of the proposals would not provide ESMA with an appropriate view of a particular CRA or of potential systemic risks within the CRA industry. In fact, some of the additional information would be difficult to provide, at best.

The proposal to provide information regarding potential and pending legal matters and litigation as well as potential cases of non-compliance with the CRA Regulation could be damaging and disruptive to the CRA. Rather, a CRA should only have to provide information on legal matters and areas of non-compliance when in fact they have materialized. To provide such information earlier, is to pre-suppose the CRA is “guilty before being proven innocent” or the CRA has surety regarding the probability of the legal matter or the incidence of non-compliance.

ESMA also proposes quarterly submission of internal complaints made by staff to the Compliance Department including follow-up actions and disciplinary measures to be reported by the CRA. DBRS would argue that this type of reporting could negatively impact any “open door” or pro-active culture established between staff and the Compliance department. Undoubtedly, staff would be reluctant to communicate any complaints or issues, actual or potential, to the Compliance department going forward. On the contrary, if this requirement were imposed, DBRS could see that staff would unlikely come forward to the Compliance Department with issues such that areas of non-compliance might begin to fester and create situations that could otherwise have been avoided. This kind of reporting puts ESMA in an untenable position of potentially creating moral hazard.

With respect to semi-annual submission of any strategy documents such as business or IT, DBRS stresses that as architectural or overarching documents, strategies tend to change less frequently and contain confidential and competitive information and nuances that are more conducive to an annual update or discussion between the CRA and ESMA.

Instead of the proposed semi-annual submission of updated organizational charts and quarterly submission of FTE headcount and staff turnover data, DBRS suggests CRAs should only have to submit material changes in management and staff when they occur. A more event driven approach would, in turn, trigger the need for dialogue with ESMA regarding the impact on the CRA’s business.

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5 CRA3 includes competition measures such as Articles 8b and 8d.
Notifications of material changes to initial conditions for registration

ESMA has outlined a non-exhaustive list of the types of material changes a CRA would have to report. DBRS suggests this is the kind of prescriptive approach that could become administratively burdensome with little supervisory benefit to ESMA.

For example, the list includes “procedures used to issue and review credit ratings”. A CRA is in the business of conducting ratings such that procedures are “business as usual” that should preclude it from being material. DBRS wonders what risk ESMA is seeking to mitigate in this case?

Rather than enunciating a list of material changes, ESMA might consider adopting a more principles-based approach to material change reporting by CRA registrants used in other jurisdictions such as in Canada and the United States. In this way, the onus or accountability is placed upon the CRA to report what it considers to be a material change, and ESMA could then determine whether dialogue with the CRA is required. Also, materiality is a subjective concept which should be proportionate or relative to the size of the CRA’s business which aligns with a principles-based approach.

DBRS welcomes the proposal for a comprehensive or “one-stop” set of periodic and material change reporting guidelines by CRAs to ESMA. These guidelines should include all prior and new disclosures and reporting requirements within the entire CRA Regulation. Any piecemeal guidance creates risks that reporting by CRAs would be inadequate and non-compliant.

Calculation of the supervisory fee and CRA market share

CRAs are required to submit audited financial statements to ESMA as part of their annual reporting requirements. These audited financial statements include revenues from rating and non-rating activities. ESMA proposes that any amounts deducted from the CRA’s turnover such as revenues from non-rating and/or non-ancillary services should be certified by the external auditor to ensure supervisory fees are calculated on a reliable and accurate basis. While DBRS does not currently engage in non-rating services, DBRS would not agree with this proposal. It should sufficient that the Chief Financial Officer or someone in a similar capacity ensure the accuracy of such deductions. In contrast, ESMA does not require external third party certifications on other financial disclosures made by CRAs including those made in the annual transparency report.

Article 8d of the CRA Regulation requires ESMA to annually publish on its website a list of registered CRAs, and include information on their total market share and the types of credit ratings issued. The calculation of CRA market share is made on the same basis as the calculation of supervisory fees, that is, the annual turnover generated from rating activities and ancillary services provided in the annual audited financial statements. However, ESMA makes the point that CRAs’ financial years differ which makes comparison difficult, and therefore, proposes that CRAs should

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6 Article 8d Use of multiple credit rating agencies
1. Where an issuer or a related third party intends to appoint at least two credit rating agencies for the credit rating of the same issuance or entity, the issuer or a related third party shall consider appointing at least one credit rating agency with no more than 10% of the total market share, which can be evaluated by the issuer or a related third party as capable of rating the relevant issuance or entity, provided that, based on ESMA’s list referred to in paragraph 2, there is a credit rating agency available for rating the specific issuance or entity. Where the issuer or a related third party does not appoint at least one credit rating agency with no more than 10% of the total market share, this shall be documented.
provide financial accounts adjusted to a calendar year basis and any adjustments should be certified by the external auditors.

DBRS questions the need for another set of certified financial statements beyond what is already submitted to ESMA, especially when the market share calculation is not an exact science. As a side note, DBRS posits that annual turnover is not an appropriate basis for the market share measurement of ratings. Rather, the number of ratings issued by each CRA would be a more suitable approach. However, DBRS understands the constraints of the current legal text regarding the basis for the calculation.

Based on the first market share report published in December 2013, of the twenty-two registered groups of CRA’s, only three CRAs were above the 10% threshold, and in total, they accounted for approximately 87% of the total CRA market share. That is, nineteen other CRAs collectively held 13% market share. Given this, an alternative to the current market share disclosure would be to simply indicate which CRAs are above or below the 10% threshold. Article 8d has not yet been fully implemented by issuers nor by EU national competent authorities. There is a general lack of awareness in the market of this important measure and hence, there is an urgent need for more action. Broader and more frequent publication of market share information would help to increase awareness of Article 8d and stimulate action.

In closing, DBRS believes that the CRA Regulation has established high standards for CRAs and a solid supervisory model for ESMA to help ensure the issuance of independent, objective and high quality credit ratings. In striving to broaden and deepen its supervision, DBRS would urge ESMA to set guidelines for additional information and reporting that help to foster, rather than hinder, compliance within and by CRAs.

DBRS appreciates the opportunity to provide its comments on the Consultation Paper and would be pleased to answer any questions ESMA may have. DBRS would also be happy to meet with ESMA to discuss its views.

Very truly yours,

Mary Keogh
Managing Director
Global Regulatory Affairs
DBRS