



**LEADING TREASURY
PROFESSIONALS**

The Association of Corporate Treasurers

Interest Representative Register ID: 64617562334-37

Comments in response to *Call for Evidence Competition, Choice and Conflicts of Interests in the CRA Industry* European Securities and Markets Authority, 3 February 2015

March 2015

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those individuals working in corporate treasury, risk and corporate finance. It is established by Royal Charter in the public interest. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments where a link to our approach regarding policy submissions can be found.

We canvas the opinion of our members through seminars and conferences, our monthly e-newsletter to members and others, *The Treasurer magazine*, topic-specific working groups and our Policy and Technical Committee.

General

The ACT welcomes the opportunity to comment on this matter. We are grateful that Verena Ross, Executive Director of ESMA, has kindly agreed to accept our response to this consultation in a format different to that set out on ESMA's website. The response templates have been designed for a single corporate to complete as distinct from a professional association representing the voice of many corporates.

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The Association of Corporate Treasurers, London, March 2015

Our comments below highlight the importance of credit ratings to non-financial users of ratings. We focus on issues raised in the call for evidence with implications that are unhelpful to corporates.

Background

Non-financial (i.e. commercial and industrial) companies (NFCs) are both rated by CRAs and are users of ratings.

NFCs solicit a credit rating as either an issuer of securities (ratings for each bond separately) or for their general credit standing (“corporate ratings”). Some CRAs issue unsolicited ratings of NFCs too. Within a group of companies, more than one group member may be rated.

NFCs use credit ratings for many purposes in their businesses. For example:

- Ratings of financial services firms, including banks, to make judgements about financial counterparties when considering investing surplus funds, transacting in derivative hedges, receiving letters of credit or other support to trade, etc. Ratings are also used in considering what type of relationship the firm may want with a bank etc. generally.
- To contribute to the making of judgements about customers, suppliers, joint venturers, and other business partners – not just other NFCs but governments and government supported entities, local governments, etc.
- As an input to the making of judgements on sovereign risk as part of their strategic decision making.

It should be noted that with the above use of credit ratings, NFCs do not usually have the credit analysis teams fully to follow their suppliers, financial counterparties, business partners, etc. Accordingly CRAs are a convenient addition to the evaluation of the credit worthiness of their counterparties. It is also important to note that, while only one consideration in decision making, credit ratings are often a starting point for credit analysis before a wide range of other inputs are evaluated, or the ratings may be a second check after the evaluation.

In general the ACT believes it is not necessary further to change CRA regulation at this time. Regulatory activism is best avoided in this field, it being desirable to allow current regulations to settle for a few years before further review.

Mandatory rotation of CRAs

The mandatory rotation requirement applying to re-securitisations has only been in place since June 2013 and hence the impact has not yet been fully felt by the markets.

The ACT doubts that mandatory rotation of CRAs is required or necessary for securitisation products. But we are sure that it is unsuitable for non-securitisation product’s ratings.

Of course, the rated firm pays the CRA’s fees when it solicits a rating. But a large part of the rated firm’s costs are in the investment of a considerable amount of time and



resource involved in the CRA's issue of the rating and the ongoing monitoring or maintenance of that rating.

The CRA must not only understand the internal policies of the firm, but also its industry, the position of the issuer within its sector and the countries within which it operates or with which it trades and, if it has a concentrated customer base, they need to understand the key customers. Forcing an issuer to rotate a rating agency undermines the importance of consistent monitoring and evaluation of the company and sector. This consistency is important to the rated firm and to those exposed to its credit – everyone that deals with the firm and communities within which it has important activities.

Mandatory rotation could also result in an issuer being forced to use a CRA that may lack the necessary experience and knowledge of a sector, making the rating less useful to all concerned. Even if it continues to solicit a rating, it may be with a CRA that it is not happy with and that may be less recognised or accepted by investors, general creditors and business partners. Such outcomes could have a detrimental impact on the efficiency of the commercial and the funding markets generally.

Additionally the ACT does not believe that mandatory rotation will improve competition amongst CRAs. The view that it might requires the assumption that credit ratings are a commoditised product, in particular, such view does not consider that methodologies and experience may be different between CRAs. The ACT believes that the variety of methodologies used by CRAs is a good thing and that adoption of one methodology by all agencies would reduce the information contained in ratings.

Issuer pays/ Investor pays model

Companies and investors will only pay for ratings if they consider them worthwhile. The competition for a solicited rating for a company is not just other rating agencies or no rating at all, but non-solicited ratings as well, paid for by investors.

The “issuer pays” model of solicited ratings arose from various historical events but the practical need for most companies to be rated to access debt capital meant they, particularly smaller companies, could not rely on investors volunteering to pay for the company's rating i.e. the “investor pays” model. And, of course, under the “investor pays” model only the investor that pays has benefit of the rating, narrowing the potential audience. The ACT believes that an “investor pays” model would likely result in a reduced number of rated companies, especially of smaller companies.

The “issuer pays” model is perceived as not independent because the issuer pays for its own rating. However we are not aware of any evidence, for the types of ratings we are considering, to suggest that an issuer is able unreasonably to influence the outcome of its rating, given the rigorous processes and standardised methodologies of the larger CRAs. What influences the rating is the information published/provided.

Issuer documentation of the consideration of smaller CRAs

Under Article 8, issuers using more than one CRA must document that they have considered a CRA with less than 10 per cent of market share, if they have not chosen one of these CRAs. Adherence to this legal provision is supervised by national regulators.

The ACT stresses that the obligation to document the non-choice of a small CRA should not become a major compliance burden on non-financial companies. In order to ensure consistency of enforcement across Europe, ESMA should issue guidance to national supervisors, outlining a pragmatic and reasonable approach to documentation requirements.



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The Association of Corporate Treasurers

The Association of Corporate Treasurers (ACT) is the leading professional body for international treasury operating in the public interest under Royal Charter. We provide the widest scope of benchmark qualifications for those working in treasury, risk and corporate finance. Membership is by examination. We define standards, promote best practice and support continuing professional development. We are the professional voice of corporate treasury, representing our members.

Our 4,600 members work widely in companies of all sizes through industry, commerce and professional service firms.

For further information visit www.treasurers.org

Guidelines about our approach to policy and technical matters are available at <http://www.treasurers.org/technical/manifesto>.

<p>Contacts: John Grout, Policy & Technical Director (020 7847 2575; jgrout@treasurers.org) Michelle Price, Associate Policy & Technical Director (020 7847 2578; mprice@treasurers.org) Stephen Baseby, Associate Policy & Technical Director (020 7847 2515; sbaseby@treasurers.org) Colin Tyler, Chief Executive (020 7847 2542; ctyler@treasurers.org)</p>	<p>The Association of Corporate Treasurers 51 Moorgate London EC2R 6BH, UK</p> <p>Telephone: 020 7847 2540 Fax: 020 7374 8744 Website: http://www.treasurers.org</p>
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