The European Association of Corporate Treasurers

Comments on ESMA's Call for Evidence on Competition, Choice and Conflicts of Interest in the CRA Industry

31 March 2015

The European Association of Corporate Treasurers (EACT)

The EACT is a grouping of national associations representing treasury and finance professionals in 18 countries of the European Union. We bring together about 12,000 members representing 6,500 groups/companies located in the EU. We comment to the European authorities, national governments, regulators and standard-setters on issues faced by treasury and finance professionals across Europe.

We seek to encourage the profession of treasury, corporate finance and risk management, promoting the value of treasury skills through best practice and education.

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1 – Introduction

We appreciate the opportunity to respond to this call for evidence. As an association representing treasury professionals we have chosen to make some general comments about the issues raised in the call for evidence and on the importance of credit ratings to non-financial users instead of responding to the individual questions posed. Some of the issues we raise are ones that we consider generally important to non-financial companies and would therefore like to document at this stage.

Companies make use of credit ratings in a variety of ways:

- to support directly and indirectly funding from the full range of financial markets;

- to assess the risks from taking on exposure to financial counterparties through investments, risk management and other transactions;
- to help assess and manage the business risks arising from trading with their customers, suppliers and business partners; and
- in the case of sovereign ratings, to reflect these in the decisions referred to above and as a significant part of strategic planning activities etc.

The process of gaining a solicited credit rating involves the issuer in providing the CRAs with confidential information on business plans and strategy and includes extensive contact with management. The quantitative and qualitative data collated is assessed by the CRAs and reflected in the ratings levels awarded and in their reports but without breaching the confidentiality of the discussions. It is thus an important mechanism for providing good quality analysis to the markets.

2 - Comments on specific issues

- **Need to review the legislation in place**

  In a general manner we consider that **there is no need to go through a legislative review of the Credit Rating Agencies Regulation at this stage**. The legal framework for credit rating agencies was extensively reviewed between 2009 and 2013 and CRA III in place currently is sufficiently robust. We do not see a need for another round of review; this would only create uncertainty and furthermore would be inappropriate as some of the provisions of CRA III have yet to enter into force.

- **Reducing over-reliance on credit ratings**

  We understand the legislative objective to reduce over-reliance on credit ratings. We would however like to stress that **this objective must not lead to banning the use of credit ratings**, at least where such a ban could have serious consequences on end-users. The most prominent example of this is probably the ban proposed by the Commission on external credit ratings of money market funds. In our view the reduction of over-reliance to credit ratings should come from sustained market encouragement not to rely solely on credit ratings, with market participants advised to conduct their own analyses so far as possible and taking ratings as one element of such analysis.

- **Mandatory rotation of CRAs**

  We have always argued that imposing a mandatory rotation of CRAs for corporate ratings would be counterproductive and inappropriate.

  A mandatory rotation would disregard the necessary investment that both the issuer and the CRA must make in solicited ratings to ensure proper understanding, not only

of the issuer (which goes without saying) but also and especially that of the industry, the position of the company in its sector, its internal policies (particularly financial and risk management) and so on. Any mandatory rotation would seriously devalue the importance of continuity in the monitoring of the company and of its business sector.

For investors that continuity is also vital so that they, and others, can monitor the track record of the CRA's views over an extended period of time and over the whole life of a long term bond.

The EACT does not believe that rotation would enhance competition within the CRA industry, because issuers are only willing to pay for ratings that are recognised internationally. Any mandated rotation would force issuers to use CRAs lacking suitable expertise and / or a recognised reputation, and consequently issuers may decide that a rating no longer has real value and elect to cease having a solicited rating. This would seriously impact the efficiency of funding markets for the real economy.

Therefore, if the legislation is reviewed, the **mandatory rotation should not be extended outside the current obligations in connection with securitisation products**.

- **Issuer pays / Investor pays model**

The EACT recognises that in the CRA industry there is no business model that would be completely free of potential conflict of interests and would at the same time be effective and provide for coverage. From the perspective of corporate issuers the 'issuer pays' business model has proven to be the most practical and suitable for both issuers and investors, even though our members have reported concern over occasions when CRAs have increased their costs significantly without any evident additional services to their corporate clients. We would like to underline that the fact that the issuers pay for their credit ratings does not in any way imply that they would be able to influence the outcome of the analysis: in our experience CRAs have rigorous processes and methods in place in order to ensure credible ratings.

We believe that any eventual move to the 'investor pays' model is likely to result in reduced coverage of companies – especially of sub-investment grade and of mid-sized and smaller companies. This would go completely against the European Union's aim to create a Capital Markets Union and would be counterproductive. Such a move may furthermore tend to reinforce the dominance of the largest CRAs, limiting the growth of real challengers as investors would need to subscribe to the incumbents because of their wider coverage.

- **The obligation for issuers to document their consideration of small CRAs**

The current legal framework lays down the obligation in Article 8 for issuers using more than one CRA to document that the issuer has considered a CRA with less than 10 per cent of market share, in the event that such a CRA was not chosen.

This obligation to document the non-choice of a small CRA should not become a major administrative and compliance burden on non-financial companies and national supervisors should adopt pragmatic and reasonable approaches. If ESMA is planning to issue guidance to national supervisors in order to harmonise their approaches for enforcing this provision, we would strongly encourage keeping the administrative impact on issuers to a minimum. Putting unnecessary burdens on issuers will not lead to any increase in competition between CRAs or improvements of the CRA industry.

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