Mr. Mohamed Ben Salem
General Secretariat
International Organization of Securities Commissions (IOSCO)
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September 5th, 2014

Reference: Good Practices on Reducing Reliance on CRAs in Asset Management – Consultation report 04/2014 dated June 2014

Dear Sir,

Reference to the publication of the above consultation, we are pleased to hereby submit the views of our association, which represents 8 ESMA registered CRAs and 5 agencies registered or recognized according to national legislation in Russia, Switzerland, Turkey and the United States. The profiles of our members are attached to this letter.

We generally agree with the analysis in your consultation report and especially with your statement in Chapter 1 that "external credit ratings represent a common language used by parties to an investment management agreement" and that "references to CRA ratings (…) may prove beneficial to investors by offering them alternative information from a third party". Your Consultation includes a detailed list of questions primarily addressed to Asset Managers and how these take into account external credit ratings[1]. In this letter, we would like to give our views on the underlying FSB Principles for reducing reliance on CRAs ratings. We conclude our letter by providing some recommendations for references to ratings in laws and regulations as well as in asset managers internal investment guidelines.

On the FSB Principles, Reliance on ratings and competition in the rating market

Your Consultation is based on the Financial Stability Board's Principles for Reducing Reliance on CRA Ratings ("FSB 2010 Principles"). While we in general support the FSB 2010 Principles and that users of ratings should not solely or mechanistically rely on CRA Ratings, we think that the approach "to remove or replace" reference to CRA Ratings should be modified to "remove, adapt, complement or replace"[2].

In May 2014, in its stock-taking exercise on the FSB 2010 Principles, the FSB stated that "the key challenge is developing alternative standards of creditworthiness and processes so that CRA ratings are no more than an input to credit risk assessment. National authorities and financial entities should guard against the temptation to adopt a small number of

[1] Your consultation makes a distinction between Ratings relating to creditworthiness of an asset and the "fund ratings" applicable to a whole portfolio of assets. We think that this distinction is material as the first is a regulated and supervised activity (in most jurisdictions) while the second is not under the scope of the EU Regulation on Credit Rating Agencies 1060/2009 as amended.

[2] please refer to our response to the FSB dated May 2013 available at our website.

alternative measures for assessing creditworthiness in place of CRA ratings, which can result in substituted procyclicality and herd behaviour"[3].

In view of these findings and that several jurisdictions have introduced stringent regulation on Credit Rating Agencies (giving Supervisors the possibility to act in case of need), we think that references to ratings are still an appropriate route to take.

The rating market is currently highly concentrated with 3 players accounting for about 90% of the global market[4]. Potential concerns with references to ratings (such as cliff effects and herd behavior) exist only because of this high market concentration. In its letter to the G20 dated April 15Th, 2013 IOSCO mentions that "new entrants face significant barriers to entry, including high start-up costs and the difficulty in changing investor preference for ratings determined by the large established CRAs. In addition, laws, regulations, and private contracts referencing credit ratings sometimes only recognize ratings issued by larger or regulated CRAs."[5].

In its May 2014 Thematic Review, the FSB reckons that "reliance on (…) ratings persists, particularly in private contracts, investment mandates, internal limits and collateral agreements". These references to ratings in private contracts are clearly a barrier-to-entry for new CRA as usually only the largest CRAs are taken into account. We therefore welcome that the FSB proposes that "Authorities should encourage market participants to review provisions within their private contracts" – such a provision was already introduced with Article 5a of the CRA III regulation in Europe in 2013.

Some potential good practices for the Asset Management industry

Based on the above analysis, we list first some recommendations regarding reference to ratings in laws and regulations as well as recommendations on Asset Managers internal investment guidelines.

- **Make reference to ratings** applicable to Asset managers "**generic**" and not referring directly to a specific CRA. Minimum requirements eg on credit quality should be defined according to sectoral legislation. As CRA may use very different rating scales, a mapping of ratings to the specified quality steps should be provided.
- **Avoid rating thresholds**: There is a difference between the existence of a rating and the level of the rating. Instead of rating thresholds, Regulatory Technical Standards from Supervisory Authorities should take into account the existence of ratings and, if required, adapt the requirements to the level of the rating (eg similar to the standardized approach where risk-weights depend on the level of the rating). Minimum rating threshold, such as the ECB Collateral eligibility criteria, lead to group behavior in case of rating downgrades and are often drivers of the liquidity of an issue.
- **Avoid rating related margins, avoid rating related collateral calls**: some financing agreements link the interest margin (or the collateral requirements) to the level of the

[3] See "Thematic Review of the FSB Principles for Reducing Reliance on CRA Ratings" dated May 12th, 2014 available at the FSB website: http://www.financialstabilityboard.org/publications/r_140512.htm
[4] See ESMA report on CRAs market shares dated December 16th, 2013 (http://www.esma.europa.eu/system/files/esma_cra_market_share_calculation.pdf) or the US SEC 2013 Annual report on NRSROs (http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep1213.pdf) for information on number of ratings assigned in the US.
[5] Available at the IOSCO website under: http://www.iosco.org/library/briefing_notes/pdf/IOSCOBN01-13.pdf

rating, thereby creating a potentially pro-cyclical loop. We recommend that such references should be replaced by specific financial measures (or other covenants) agreed by the financing parties.

- Supervisors should **propose rules on how to use several ratings**. Ideally, not one single rule should be proposed but different approaches could be presented[6]. Asset Managers may then select the approach which best meet their own requirements and views. This “flexible approach” will avoid harmonizing the approaches in the asset management industry and contribute to financial stability.
- **Asset managers should use all ratings available**. Since CRA use different rating methodologies to derive their ratings, using several sources may shed additional light onto the rated entity (eg by identifying different risk drivers). Using several CRAs ratings automatically reduces the asset manager’s dependence on a single CRA rating action and thereby increases financial stability (and reduces cliff effects). In order to facilitate this task, CRA Supervisors should make easily available the list of supervised and recognized agencies[7]. Given the global approach in the asset management industry, we propose that Asset Managers may reference any CRA registered or recognized in accordance with national legislation applicable in the asset’s country of residence and any CRA applying the IOSCO Code of Conduct on CRAs[8].
- In case of a **downgrade beyond a specified rating level**, Asset Managers should retain flexibility whether and when[9] they sell the specific asset. Asset Managers should review whether the concerned asset still meets other relevant factors at the time of the investment decision (eg liquidity of the asset, maturity, pricing etc) and may thereafter decide to keep the asset. Internal investment guidelines may limit such “retained” exposures to eg 10% of all assets under management.
- Last but not least, we think that the size and the **degree of sophistication of the investment managers** needs equally to be taken into account. While very large and highly-sophisticated investors may use ratings as one component of their analysis (or to test their own assumptions), smaller investors may rely more on ratings. We therefore recommend that the envisaged good practices should take into account the different sizes of the asset managers and provide for a proportionate approach. Requiring small investors to set up own internal credit assessments for all assets may be too burdensome and expensive.

We thank you for your attention and remain at your full disposal for any clarifications or if we can be of any further assistance to you.

[6] Some examples on how to use several ratings are the following: average rating, second best rating, second lowest rating and more sophisticated approaches such as the rules on the use of several ECAI ratings (which depends on the risk weigths assigned to each rating).
[7] As good practices for publishing the list of registered CRAs, we would like to mention ESMA or the US SEC. We would welcome if all jurisdictions would follow this good practice.
[8] IOSCO is currently in the process of revising the Code of Conduct on CRAs, which includes several new proposals.
[9] As an example, the concept of introducing a grace period following a downgrade is currently a proposal by the European Supervisory Authorities regarding risk mitigation techniques for OTC-derivative contracts not cleared by a CCP.

Sincerely yours

Thomas Missong — EACRA President

Adolfo Estevez Beneyto — EACRA Secretary General

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 10 European countries and include the following companies:

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.

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 Group: 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 a joint venture between Dagong Global Credit Rating (60% ownership) and Mandarin Capital Partners (40%), led by Ulrich Bierbaum as General Manager. Dagong Europe provides European and Asian investors with credit opinions on financial institutions (including insurance companies) and non-financial corporate.

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.

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

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

Informa is the Marketing, Financial and Business Information leading company in Portugal, offering currently more than 820K online scores on Portuguese companies.

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

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).

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.

Scope was founded as an independent rating agency in Berlin, Germany, in 2002. The company is specialized in ratings and analysis of SMEs, bonds, certificates and funds across Europe.

The Members of the Association have very different business models while assigning ratings. All are deeply rooted in their respective markets; enjoy a high market share and a good reputation with local investors.