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Credit Rating Agency Regulation – a case for reform

Dear Mr Deckers,

Both the German fund association BVI and the German insurance association GDV participated in ESMA´s recent call for evidence on the availability and use of credit rating information and data.[1] While we highly appreciate ESMA´s effort to protect ratings data users from excessive credit rating agencies (CRAs) licencing fees, we see a strong case for regulatory intervention by the EU Commission to achieve this aim.

Both fund managers and insurers, as two of the largest institutional investor groups in the EU, are regular users of credit ratings data for investment management, risk management, compliance and regulatory reporting, as well as accounting purposes. They use ratings and ancillary services provided by credit rating agencies and their data entities intensively within their group. As a matter of fact, external credit rating information is not least for regulatory reasons indispensable for European fund managers, insurers, and other institutional investors such as banks. In this sense, regulated investors face something quite close to an obligation to contract.

Following intensive discussions since the inception of the Credit Rating Agency Regulation (CRAR) both with our members as well as directly with major credit rating agencies we are concerned about the continuing negative business conduct of the three largest US-based CRAs S&P, Moody´s and Fitch. In our view these CRAs take inacceptable advantage of their oligopoly-like market position to the detriment of both retail and institutional investors and, hence, ultimately the consumers.

[1] https://www.esma.europa.eu/sites/default/files/library/esma33-5-829_call_for_evidence_on_access_and_use_of_ratings.pdf

In doing so, they strongly harm the efficiency of capital markets in the EU. In addition, they put European market participants and rating agencies at a competitive disadvantage internationally.

Due to their dominant market position, institutional investors are *de facto* forced into licence agreements with these largest US-based CRAs.

EU legislation increasingly encourages the use of credit ratings, such as CRR for banks and Solvency II for insurers.

Therefore, it is next to impossible for regulated and supervised credit ratings data users such as insurers under Solvency II or asset managers under UCITS, AIFMD and MIFID to escape the triple impact of

- recurring massive price increases,
- new data licence types aiming to capture all credit rating use cases along the value chain
- and increased data licence management and compliance and audit efforts.

Demand for credit ratings is highly inelastic, as ratings must be used based on client or regulatory requirements. The three CRAs have been able to enforce excessive fee increases of between 5 and 25 percent p.a. for credit rating information needed by both asset managers and insurers.

Such price increases are not always direct but do come indifferent forms and formats. For example, for an insurer which has licenced ratings data and other CRA products or services (bundled agreements) it is almost impossible to terminate the additional product licences and retain only the rating data feed. The CRAs will protect their revenue base by asking the same prior fees for the ratings data alone. As the insurer is forced to use ratings data, the CRA will have the upper hand in any price negotiation.

Given the current CRA market structure and business practices, we strongly believe that the commercial issues surrounding CRA data licencing practices need to be firmly addressed through regulatory intervention by the EU Commission. ESMA on its own – in spite of its good efforts over the past years – is lacking the necessary regulatory powers to efficiently protect rating data users from the oligopolistic CRA behaviour.

We therefore recommend to introduce MiFID-like data user protection features into the CRAR in terms of pricelist and cost of data production disclosure as well as cost-based pricing requirements on CRA ancillary (data) services. What is more, revising the CRA III is necessary to clarify that all CRA (data) subsidiaries also fall into the scope of the CRAR. A strict and transparent cost regulation of rating information services that are not marketed by the regulated analytical units of the CRA groups is needed to

stop inacceptable market practices by the non-regulated entities of CRA groups.

Furthermore, the Commission should strengthen ESMA's regulatory and supervisory powers to improve the usability and acceptance of the European Rating Platform (ERP) and the CRAs (regulatory) websites by

- allowing for access to and download/data feed of rating data in standardised, structured, machine readable formats also through data vendors,
- securing licence and fee free internal and external use of rating data for direct as well as indirect reporting, including asset manager-to-investor for regulatory reporting purposes on assets held for such investors,
- disallowing "derived data" licenses on services which are based on CRA website or ERP data. A case at hand is the calculation of the CQS score for insurer holdings based on ERP rating information in the context of Solvency II.

We would welcome the opportunity to discuss these issues in more detail with you and remain at your entire disposal for any question you may have.

With best regards

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