Position Paper

Response to ESMA call for evidence on credit rating information and data

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Contact person:	Andrea Pintus, Policy Advisor, Investments	E-mail:	ecofin@insuranceeurope.eu
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Summary

Insurance Europe strongly welcomes the European Securities and Markets Authority's (ESMA) work on credit rating information and data to map the key activities undertaken by users of credit ratings and investigate users' preferences about subscribing to third party data fee service providers, rather than relying on free of charge information on the European Rating Platform (ERP) and credit rating agencies' (CRAs) public websites.

Given their large and diversified investment portfolios, insurers are dependent on ECAI CRAs with an equally large and diversified market coverage. Credit ratings are necessary to meet requirements and perform calculations under the Solvency II framework, as well as preparing reporting to public authorities. Credit ratings are also a central and integral part of an insurer's approach towards risk management, its investment portfolios and strategy. As such, they are a vital component in enabling insurers to carry out their core business and activities.

In several market segments, instruments are almost exclusively rated by three main US-based CRAs (S&P, Moody's and Fitch), in what could be considered as an oligopolistic market structure. It would therefore be challenging for insurers to replicate CRA rating methodologies and research in a cost-effective way. This market concentration comes to the detriment of institutional investors who need to subscribe to CRA licencing in order to rely on ratings for risk management and regulatory reasons.

Insurance Europe aisbl
Rue Montoyer 51, B-1000 Brussels
Tel: +32 2 894 30 00 • Fax: +32 2 894 30 01
E-mail : info@insuranceeurope.eu
www.insuranceeurope.eu

To make the **credit ratings published in CRAs' websites more useful and easier to access**, the industry has the following suggestions:

- First of all, the CRAs' websites should state clearly that it is possible to use the ratings by CRAs without a license agreement for internal and regulatory purposes. Intellectual property laws are also an obstacle to this as a contractual relationship through the issue of a licence is commonly used to govern such use of data. Since the implementation of Solvency II, there have been some significant increases in the cost of these licences.
- Second, CRA websites should allow for export options with an automated and free-of-charge provision of rating data in a structured data format. Process optimization features are especially needed and valuable, as retrieving data on various websites and solutions is often ineffective. For this reason, insurers rely on additional tools: eg the Bloomberg Data License (BDL).
- Third, it would be helpful for CRAs to publish clear and transparent descriptions of their services and the associated costs. There is currently a lack of commercial transparency surrounding the licensing process.

To improve and make the **credit ratings in the ERP** a primary source of rating information, the industry has the following suggestions:

- Third-party data feed providers would use ERP information if it were free and appropriate for use as a primary source of rating information. This is only possible if there is legal certainty that the ratings are freely available for internal and regulatory purposes, without a license agreement.
- Specific improvements need to be introduced to make rating information retrievable in a structured automated manner: eg the automated upload of a portfolio of relevant IDs to obtain the relevant data, more frequent and timely updates, flexibility in time periods for the ratings, improved traceability of data, etc.

Detailed Comments

Questionnaire A - for users and potential users of credit rating data

7.1.1 Background information

***Q1**: Name of respondent or organization*

- Insurance Europe

***Q2**: Country of residence*

- Belgium

***Q3**: Type of stakeholder (Supervisory authority; other public authority; industry association; bank; insurance undertaking; investment firm; asset manager; NGO)*

- Industry Association

***Q4**: If applicable, please provide an estimate of the organisation's annual turnover in the financial year 2019*

N/A

7.1.2 Activities in which credit ratings are used as an input

***Q5**: Please describe in as much detail as you can, each of the main activities for which you use credit ratings as an input (e.g. risk management, investment strategy, market research, supervision, etc). Subsequently, please answer the following questions for each of the described activities:*

- Credit ratings are used to meet requirements and perform calculations under **Solvency II,** as well as in preparing **reporting to public authorities**. They are widely used as part of risk management processes, in developing investment policies, and in dealing with counterpart and concentration risks.
- Current credit ratings on individual assets are used to feed into **Matching Adjustment and capital calculations** in Solvency II. The transition rates on those ratings are used to inform modelling and analysis.
- Credit ratings are also a central and integral part of managing **investment portfolios and strategy** within defined investment limits, and reinsurance exposures within defined counterparty limits, therefore enabling insurers to stay within the limits defined by their risk appetites. This includes overall exposure to credit risk, but also concentration exposure to single counterparties such as banks, corporate entities, governments, etc.
- Credit ratings are also often used in **prospectuses for investment funds**. In some instances, the quality of investments or associated risks are managed and defined so that certain bonds will not be eligible for the products if they receive a rating below, eg investment grade.
- Credit ratings may have **indirect relevance** too: eg via fund managers handling credit portfolios for insurers. These managers apply ratings and also have restrictions on the quality.

(A) *Is the activity necessary for your organisation to be able to fulfil a regulatory requirement (if so, please explain which one)?*

- Solvency II
  - QRT reporting – credit rating disclosure is required for Solvency II reporting of asset QRTs (S.06.02) at an individual holding level.
  - Capital modelling – both standard formula and internal model users.
- IFRS accounting
  - Financial disclosures.
  - Calculation and disclosure of impairment provision.
  - Credit quality of debt securities.

(B) *Is the activity necessary for your organisation to be able to deliver a part of your core business (if so, please explain how)?*

Yes, they are necessary for the following reasons:

- Customers, brokers and shareholders want to know and understand an insurer's financial strength before investing or entering insurance / reinsurance contracts.
- Insurers monitor the credit quality of assets as part of regular compliance checks to ensure investment holdings remain within their risk appetite and comply with their investment and asset liability matching (ALM) strategies.
- Even if insurance companies have fund managers handling their credit portfolios, they are indirectly dependent.
- Insurers must comply with regulatory disclosure requirements.
- In addition, insurers need to have confidence in the strength of the reinsurance counterparties to which they have ceded risks.

(C) *How important are credit ratings in enabling to carry out this activity? (indispensable/important/desirable/optional. Please explain why)*

- Credit ratings are **indispensable** for an insurer's activities.
- It would be both impossible and impractical for a business to monitor, measure, manage and report its credit risk or concentration risk without reference to them.
- Credit ratings provide an independent and market observable view that satisfies external audit requirements. They allow like-for-like comparisons to be made around risk profiles when comparing firms' holdings for the lay investor.
- Credit ratings for externally rated assets are needed to map to fundamental spreads and to calculate the matching adjustment.
- CRAs have the systems, processes, controls and access to resources to maintain rating methodologies and research/publish ratings. For insurers it would be challenging to replicate this in a cost-effective way. Indeed, internal ratings are not available for most insurers since the regulatory requirements are too strict. But even insurers with internal models are dependent on external credit rating information to some extent, since internal ratings are often not fully equivalent in terms of amount and detail of processed information, model quality and timeliness.

(D) *Does this activity necessitate the transmission of credit rating data within your organisation and/or to third parties such as clients or public authorities (if so, please explain to whom, how and why)?*

- Individual, aggregated and processed rating data is exchanged within the organisation (eg to the board) and must be made available to auditors and regulatory authorities in the context of solvency and statutory reporting, as well as to the public via annual reports.

(E) *For the purposes of this activity, what frequency of updates is necessary (real- time / lag of less than 15 minutes / daily / monthly / quarterly / other)?*

- Updates in real time, daily, monthly and quarterly will all be required, and will depend on the analysis being performed. If a firm is looking to acquire credit securities, real time updates will be required. For the purposes of financial and regulatory reporting, quarterly updates are appropriate.

(F) *For the purposes of this activity, is there a specific software format in which you need to receive the data (e.g. XML, CSV, JSON, other). Please explain which and why?*

- In order to ensure an automated process for the provision of data, a structured data format is needed (eg .txt, .xml, .csv, .xlsx).

(G) *For the purposes of this activity, which specific data characteristics do you need and why (e.g. rated instrument ISIN, rated entity LEI, CRA LEI, date, solicitation status, endorsement status…)?*

- The following data characteristics are required for Solvency II asset QRT (S.06.02):
  - Instrument credit ratings
  - Issuer credit ratings
  - Ultimate parent credit ratings
  - Sovereign credit ratings
  - Legal Entity Identifier (LEI) in relation to issuer and parent issuing entities
  - International Securities Identification Number (ISIN)
  - CRA rating office name / LEI
  - CRA endorsement status of rating
  - Ratings outlook (eg positive, negative, stable)
  - Date of the rating

(H) *For the purposes of this activity, what other CRA information is indispensable (e.g. press releases, ratings reports, data models, methodologies, research papers etc.)?*

- In order to improve the informational basis for portfolio management, internal risk management and to comply with the requirements of the CRA III regulation (assessments and plausibility checks on external credit ratings), some but not all insurers use:
  - Rating methodologies
  - Research information
  - Press releases
  - Details of exposures moved to negative watch

(I) *For the purposes of this activity, which coverage of rated entities/instruments do you need (e.g. all German corporates, all instruments traded on regulated markets in the EU etc.).*

- Credit ratings are required at an instrument-, issuer- and parent issuer level.
- The insurance sector will require data for all debt securities (including both investment grade and high yield) traded and non-traded worldwide. A similar requirement applies for reinsurance counterparties.

(J) *For the purposes of this activity, which CRAs' credit ratings do you need and why (i.e. only some ESMA registered CRAs, all ESMA registered CRAs, all ESMA registered CRAs as well as one or more non-EU CRAs)?*

- Given their large and diversified investment portfolios, insurers are dependent on ECAI CRAs with an equally large and diversified market coverage. The three credit rating agencies that have by far the largest market coverage are S&P, Moody's and Fitch. In several segments, instruments are almost exclusively rated by S&P, Moody's and Fitch, in what could be considered as an oligopolistic market structure. As a consequence, insurers are de facto dependent on these three credit rating agencies to fulfill and execute the activities described under Q5.
- Insurers will often need to rely on all three CRAs (S&P, Moody's & Fitch) since not all instruments are covered by all three agencies. These ratings are required for managing compliance rules (eg investment limits in bonds below investment grade) and for managing the products made available to clients, where there are rules that require worst rating of two or more different CRAs.
- Other companies only use one CRA to limit expenses.

7.1.3 CRAs' websites – current use and potential changes

***Q6**: Please indicate the level of use by you/your organisation (exclusive, primary, secondary, occasional, none) of the public website of CRAs, explaining why or why not you rely on CRAs' websites as your primary source of rating information. Please specify which CRAs' websites you use in practice.*

- Insurers will typically make only limited, occasional use of CRAs' public websites. This may be to verify ratings to support Solvency II QRT reporting (if the usual sources report unexpected results) or to access research papers.
- The main reason for the limited use of public websites is that CRA websites do not allow for an automated and free-of-charge provision of data in a structured data format.

***Q7**: Some CRAs recently changed the terms of use of the free public information disclosed on their websites, for example to permit internal use and use of credit ratings for regulatory reporting. Please explain what impact, if any, this has had on your use of the public websites of those CRAs?*

- Experience suggests that (contrary to the premise of this question) CRAs use intellectual property laws to prohibit the use of credit ratings both for insurers' internal use and regulatory reporting.
- A contractual relationship through the issue of a licence is commonly used to govern such use of data, and there have been some significant increases in the cost of these licences since the implementation of Solvency II. Typically, an insurer will have a licence with a CRA allowing it to source ratings data from a third-party data provider such as Bloomberg.
- CRAs are fully aware of what organisations are doing with the credit rating data they provide, as they require detailed questionnaires to be completed annually prior to the renewal of licences.

***Q8**: Please explain what further changes to CRAs' websites would be necessary in order for you to make the credit ratings published there more useful and easier to access? Please explain the positive and negative impacts to your organisation of implementing those changes.*

- First of all, the CRAs' websites should state clearly that it is possible to use the ratings by the CRAs without a license agreement for internal (risk management) purposes and for regulatory purposes (eg Solvency II).
- Second, CRA websites should allow for export options with an automated and free-of-charge provision of rating data in a structured data format. In general, the industry notes that process optimisation features are especially needed and valuable, as retrieving data on various websites and solutions is often ineffective. While, most CRAs have solutions for obtaining ratings, they are often inadequate as they have to be combined with a variety of additional information that is unavailable. For this reason, insurers rely on additional tools, eg the BDL.

- Additionally, the insurance sector takes the view that it would be helpful for CRAs to publish clear and transparent descriptions of their services and associated costs. There is currently a lack of commercial transparency surrounding the licensing process.
- While other website information would be of value, European insurers take the view that CRAs are unlikely to provide this service without charge. Desirable useful information and helpful features include:
  - Data dump or retrieval approach. At the moment, this is not a possibility as CRA websites typically only allow one bond at a time to be viewed based on an ISIN.
  - The supply of all available ratings per issuer.
  - Greater ratings availability and coverage. Not every bond is rated by a CRA.
  - Additional information and analysis which helps insurers complete climate change related stress test exercises.
  - A website in local language, especially for smaller and medium sized insurers.

***Q9**: Please explain the positive and negative impacts to your organisation of making the following changes to CRAs' websites:*

***(A)** Making credit rating data freely downloadable in CSV format?*

- If this service were to be freely usable for internal and regulatory purposes, available in a timely period, with efficient processes, and allow companies to make savings by relinquishing existing licences, then this would be a cost-effective and viable option with a positive impact.
- The industry notes that downloading ratings is not necessarily as easy as it may look, as ratings data can be quite complicated. If free download was an option, the industry could make a clearer assessment of positive and negative impacts. In this scenario, the use of BDL should not require a license.

***(B)** Making credit rating data freely machine-to-machine downloadable in XML or JSON format?*

- See answer to Q9(A) above.

***(C)** Making further changes to the terms of use?*

- Making it legal for insurers and their asset managers to distribute to clients rating information in an electronic format (this is already possible if the client receiving the information also has a contract in place with CRAs).
- It is not sufficient to publish modified "terms of use" on the website. This should apply to all related data.

***(D)** Other?*

- Insurers are considering creating internal ratings for unrated securities: eg when investing in alternative investments.

***Q10**: Where you have identified negative impacts to making any of the changes listed in response to Q9 above, please explain whether there are any measures which could be adopted to mitigate these negative impacts.*

- This can be a positive initiative if credit rating data is made freely available for the entire investment universe of insurers, in a downloadable format (bulk files) including a daily 'changes to ratings' file.

- However, changing conditions and availability of data on websites might not address the problem that companies are forced to have expensive, individual licenses.

7.1.4 Credit ratings via a paid data-feed – current use and characteristics

***Q11**: Please indicate the level of use by you/your organisation (exclusive, primary, secondary, occasional, none) of a paid data-feed as the source of rating information/data explaining why or why not you rely on a paid datafeed as your primary source of rating information.*

- Note that third-party data providers do not typically charge for sending credit rating agency data from the CRAs (in other words, firms do not pay for a "data feed"). It is the CRAs themselves that charge via licences. Before the third-party provider allows an insurer to access the information, it must provide evidence of this licence.
- The main reason for needing a paid data feed is for the frequency of updates and the granularity of the data. Data from the ERP is updated too infrequently to be useful for ongoing monitoring of experience relative to the wider market.

***Q12**: If you or your organisation relies on a paid datafeed, please describe the characteristics of this datafeed:*

***(A)** What is the name of the data-feed and the name of its provider?*

- Insurers have built solutions for downloading and importing data from CRAs into their investment management systems, and most insurers have built a solution capturing rating information via Bloomberg.

***(B)** Does this datafeed allow for the transmission of credit rating data internally within your organisation and/or to clients, contractors or public authorities (to whom and how is transmission permissible)?*

- The data feed only caters for the transmission of credit rating data into investment management systems for internal use.
- Insurers do not pass rating information on to clients (only regulators) unless the client also has a contract with the CRAs in place.
- The paid data feeds generally allow an internal as well as an external use of rating information. However, the respective individual license agreements with the CRAs must be considered also, since they often limit the use of information to internal or regulatory reporting.

***(C)** What is the frequency with which you receive updated rating data through this source (real-time / lag of less than 15 minutes / daily / monthly / quarterly / other)?*

- Many insurers use rating data updated on a daily frequency, while for other activities updates are less frequent.

***(D)** In which format (e.g. XML, CSV, JSON, other) do you currently receive rating data?*

- Many insurers receive data in XML & CSV.

***(E)** Which specific data characteristics does the rating data you currently receive include (e.g. rated instrument ISIN, rated entity LEI, CRA LEI, date, solicitation status, endorsement status…)?*

- Some rating data received will be incomplete and require additional work in-house by the insurer to ensure the data is fit-for-purpose.
- Many insurers capture: date, rating, rating agency, issuer rating, ISIN & LEI – and they capture this via Bloomberg.
- Please refer to answer to Q5 (G).

(F) *Which coverage of rated entities/instruments does the rating data you currently receive include (e.g. which geographic zones, asset classes etc)?*

- Many insurers are global investors, and some have investments across over 100 different countries (eg in Europe, emerging markets, North America & Asia Pacific etc) and across multiple types of bonds (eg fixed rate, floating rate, adjustable, irregular, zero etc)
- Please refer to answer to Q5 (I).

(G) *Which CRAs' ratings are included in the rating data-feed?*

- Many insurers will have contracts in place with S&P, Moody's & Fitch.
- Please refer to answer to Q5 (J).

(H) *Does your subscription include other CRA products or services (e.g. press releases, ratings reports, data models, methodologies, research papers etc.)?*

- Some licences will bundle limited access to CRA core website information; however, insurers do not tend to be reliant on this.

(I) *Please provide the total fees paid by you or your organisation in 2019, 2018 and 2017 to access and use credit rating data. If your organisation pays a fee to more than one entity (e.g. several CRAs/ CRA affiliates/data service providers/Intellectual Property right holders etc) please break down the fee per entity. Please provide explanations as necessary.*

- Insurers will not disclose individual commercial terms regarding CRA licencing; however, the fees are significant, and have been increasing significantly year-on-year since the implementation of Solvency II.

7.1.5 Credit ratings via the ERP – current use and potential improvements

Q13*: Please indicate the level of use by your organisation (exclusive, primary, secondary, occasional, none) of the ERP, explaining why or why not you rely on the ERP as your primary source of rating information.*

- Use of the ERP tends to vary between "occasional" and "none". The main reasons for this are:
  - Rating information is not retrievable in a structured manner. Filter options are missing, eg filter functionality at the CRA level.
  - There is legal uncertainty regarding the free-of-charge usability of the ERP. Before accessing the ERP, users have to accept (by clicking) that the data can be "subject to third party proprietary rights". Therefore, the users might understand that they accept to enter into a license agreement with the (three US-based) credit rating agencies when entering the ERP.
  - Necessity to enter captcha is not feasible if a large number of queries have to be carried out.
  - There are already functioning fully automated processes in place.
- Some insurers report using data from the ERP to inform capital model calibrations.

Q14: *Please explain what specific changes to the ERP (e.g new technical functionalities, data presentation and accessability) would be necessary in order for your organisation to use it as your primary source of rating information?*

- European insurers note that third-party data feed providers would use the information from the ERP to provide to their clients, if it were free and if it were appropriate for use as a primary source of rating information.
- For this to be possible, the database should eliminate the expectation/assumption that companies still collect their data area by area and then put them together. This would be inefficient and very costly, as IDs and date rarely fit across platforms.
- Specific improvements Insurance Europe would like to see on the ERP portal are:
  - Automated upload of a portfolio of relevant IDs to obtain the relevant data. This is key for practical usage.
  - More frequent and more timely updates, ideally monthly, with no more than a one-month lag.
  - Provision of historic rating information by date.
  - Ability to use time periods other than half years starting on 1 January and 1 July.
  - Information at rating notch level, rather than CQS level.
  - More granular sectoral classifications.
  - Improved traceability of data, including clear definitions of the classification systems used, how multiple issuances by the same issuer are treated and any mappings applied.
  - Ability to analyse the extent to which the rated issuers overlap between the different rating agencies.
  - Clarity about whether the data is 'free of charge'. If the data on the ERP is not "free", then it must be clear that to copy data into own databases a licence is required.
  - Functionality to automatically produce transition matrices averaged over multiple periods and to export in a single step both the average matrix and each of the constituent matrices. Producing average transition rates from the ERP portal currently requires multiple individual queries.

Q15: *Please explain the positive and negative impacts to your organisation of making the credit ratings on the ERP and indicate if you are in favour of such changes:*

(A) *Freely downloadable in CSV format?*

- This would have a very positive impact and would be a step in the right direction.
- Together with the points mentioned under Q14, insurers would be able to exclusively switch to the ERP if the ratings are freely available for internal purposes and for regulatory purposes, without a license agreement. Switching to ERP with continued free access would result in significant annual savings for companies. Also, given the significant regular license fee increases this would reduce financial costs and dependencies significantly. However, at this stage, due to the need to keep processes efficient, it is unlikely that insurers will run daily manual processes before the ERP becomes more efficient.

(B) *Freely machine-to-machine downloadable in XML or JSON format?*

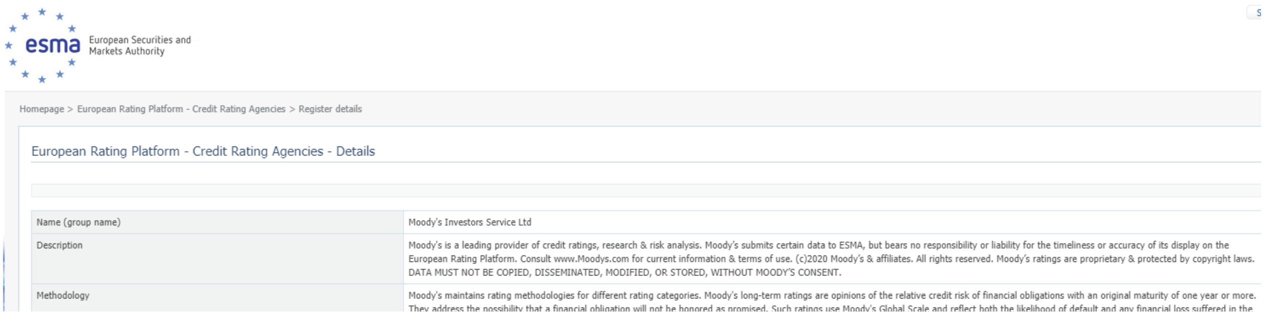
- This would have a positive impact and would be a step in the right direction.
- This change would be positive due to use of automation for creating efficient processes.

(C) *Making further changes to the terms of use?*

- As highlighted above, one of the main issues to be solved is for data to be truly free and ready for use internally by insurers and their asset managers. It should be possible to store, analyse and distribute the data in the ERP, as well as use them in reporting to regulators and clients.

__Q16__: Where you have identified negative impacts to making any of the changes listed in response to Q14 and Q13 above, please explain whether there are any measures which could be adopted to mitigate these negative impacts.

- No negative impact identified above, but clarity on the use of data is needed. For the proposed changes to be fully valuable, the ratings should be freely available for internal purposes and for regulatory purposes without the need of a license agreement. Currently, as it can be seen in the image below from Moody's (extracted from ERP), there is a warning saying that "<u>data must not be copied, disseminated, modified, or stored, without Moody's consent</u>".



7.1.6 Additional relevant information and evidence

__Q17__: Please use this space to provide any further information you would like to bring to ESMA's attention and to attach any relevant evidence in support of your responses to the questions above?

- The three US-based CRAs take excessive advantage of their oligopoly-like market position to the detriment of institutional investors who rely on ratings for risk management and regulatory reasons. As a consequence, institutional investors are de facto forced into license agreements, even if the respective ratings have been fully paid for and have been made publicly available on websites and in press releases.
- Insurance Europe therefore strongly believes the commercial issues surrounding CRA licencing in Q8 need to be addressed by ESMA and the EU Commission.
- Discussions with CRAs have made clear that the agencies believe that currently only the CRA units that actually assign credit ratings fall under the CRA III regulation, but not the subsidiaries distributing the ratings. Therefore, the insurance industry recommends revising CRA III in order to clarify that all CRA subsidiaries fall under the scope of the CRA III regulation.

Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers pay out almost €1 100bn annually — or €2.9bn a day — in claims, directly employ over 900 000 people and invest nearly €10 200bn in the economy.