

21 January, 2014

---

**CONTACT**

James Warbey  
Partner  
+44-20-7615-3064  
jwarbey@milbank.com

Christopher Wall  
Associate  
+44-20-7615-3141  
cwall@milbank.com

---

## Alternative Investments Group Client Alert: ESMA Publishes CRAs' market share calculation paper

On 16 December 2013, the European Securities and Markets Authority (“**ESMA**”) published on its website a paper entitled “CRAs' Market share calculation according to Article 8d of the CRA Regulation”<sup>1</sup> (the “**Paper**”). The Paper fulfils ESMA's obligations under new Article 8d(2)<sup>2</sup> of Regulation (EC) No 1060/2009 on credit rating agencies (the “**CRA Regulation**”) and sets out a list of credit rating agencies registered in the European Union (“**Rating Agencies**”) indicating their total market share, together with the types of credit ratings issued (classified as sovereign ratings, corporate ratings<sup>3</sup>, structured finance ratings and covered bond ratings).

In this Client Alert, we focus on the contents of the Paper and address a number of questions as they affect, in particular, issuers and arrangers of structured finance transactions.

**Q1. REMIND ME WHAT ARTICLE 8d IS?**

**A.** Article 8d of the CRA Regulation was introduced by Article 1(11) of Regulation (EU) No 426/2013 (“**CRA III**”). Article 8d(1) provides that where an issuer or a related third party intends to appoint at least two Rating Agencies for the rating of the same issuance or entity, the issuer<sup>4</sup> or a related third party<sup>5</sup> is required to consider appointing at least one Rating Agency that has no more than 10% of the total market share<sup>6</sup>. Where the issuer or a related third party does not appoint at least one Rating Agency with no more than 10% of the total market share, there is a requirement that this be documented.

Article 8d(2) requires EMSA to publish annually on its website a list of registered Rating Agencies, indicating their total market share and the types of credit ratings issued which can be used by the issuer as a starting point for the evaluation discussed in the paragraph above. We note that the legislation has omitted reference to “related third parties” here, however, we see this as unintentional and related third parties should also use the Paper as a starting point for such an evaluation for their transactions.

**Q2. IS THERE ARE REQUIREMENT TO HAVE TWO RATING AGENCIES ON ALL TRANSACTIONS?**

**A.** No. It is only a requirement under the CRA Regulation<sup>7</sup> that where an issuer or a related third party intends to solicit a credit rating for a structured finance instrument<sup>8</sup>, at least two independent Rating Agencies shall be appointed.

**Q3. SO WHAT DOES THIS PAPER MEAN FOR ISSUERS AND RELATED THIRD PARTIES?**

**A.** The obligation of issuers and related third parties under Article 8d(1) to consider and document the choice of Rating Agencies was effective as of 20 June 2013. However, prior to the publication of the Paper, little publicly available data existed which clearly set out the precise market share of each Rating Agency in order to evaluate a Rating Agency's market share and their capability to rate transactions. Accordingly, issuers and related third parties had to make informed decisions based on perceived (as opposed to actual) market data. Now that ESMA has published the Paper, such parties will now have a useful source to refer to when making such evaluation. This in turn gives greater comfort to those making the decision.

**Q4. HOW DOES ESMA CALCULATE TOTAL MARKET SHARE?**

**A.** The total market share is measured with reference to the annual turnover from credit rating activities and ancillary services, at group level, generated by Rating Agencies. The total turnover is calculated with respect to credit rating activities and ancillary services.

Credit rating activities includes the provision of opinions in relation to “an entity, a debt or financial obligation, debt security, preferred share or other financial instrument, or of an issuer of such a debt or financial obligation, debt security, preferred share or other financial instrument”<sup>9</sup> and ancillary services comprise “market forecasts, estimates of economic trends, pricing analysis and other general data analysis as well as related distribution services”<sup>10</sup>.

**Q5. SO WHICH REGISTERED RATING AGENCIES ISSUE STRUCTURED FINANCE RATINGS?**

**A.** There are, unsurprisingly, a very limited number of EU registered rating agencies in Europe that provide structured finance ratings. The Paper lists Moody's<sup>11</sup>, Fitch<sup>12</sup>, S&P<sup>13</sup>, Creditreform Rating AG, DBRS Ratings Limited (“**DBRS**”) and Scope Credit Rating GmbH as Rating Agencies providing structured finance ratings. Unhelpfully, the total market share calculation is by reference to credit rating activities and ancillary services<sup>14</sup> and does not narrow down into specific ratings categories which makes it difficult to gauge deal volume and experience in a specific rating sector such as structured finance. It should not, however, be difficult for market participants to infer from the percentages set out in the Paper and their experience generally that Moody's, S&P and Fitch are the key players for structured finance transactions. We have, however, seen DBRS provide structured finance ratings in, for example, European CMBS<sup>15</sup>, Auto ABS<sup>16</sup> and to a very limited extent, CLOs<sup>17</sup>.

For such issuers and related third parties the Paper should be, to some degree, welcomed as they now have an official source to justify, if so required, their selection of Rating Agencies to rate a structured finance instrument.

**Q6. HOW DOES THE ISSUER OR RELATED THIRD PARTY “DOCUMENT” ITS DECISION? ANY EXAMPLES TO DATE?**

**A.** As noted above, Article 8d(1) requires the choice of Rating Agencies which rate structured finance instruments to be “documented”. Unhelpfully, there is no guidance as to what “documented” entails. However, we have seen a number of different ways that issuers have sought to comply with this provision. In a recent Milbank CLO<sup>18</sup>, the directors of Dryden 29 Euro CLO 2013 B.V., a Dutch issuer, sought to achieve compliance by documenting their decision in the transaction board minutes with related disclosure in the offering circular.

**Q7. WHAT ARE RELATED THIRD PARTIES?**

**A.** The definition of related third parties is set out in Article 1(i) of the CRA Regulation and means an originator<sup>19</sup>, arranger, sponsor<sup>20</sup>, servicer or any other party that interacts with a Rating Agency on behalf of a rated entity, including any person directly or indirectly linked to that rated entity by control.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

---

<sup>1</sup> [http://www.esma.europa.eu/system/files/esma\\_cra\\_market\\_share\\_calculation.pdf](http://www.esma.europa.eu/system/files/esma_cra_market_share_calculation.pdf).

<sup>2</sup> Article 8d(2) of Regulation (EC) No 1060/2009 as amended by Regulation (EU) No 426/2013.

<sup>3</sup> Corporate ratings includes non-financial, financial and insurance ratings.

<sup>4</sup> “Issuer” is defined in the CRA Regulation as an issuer as defined in Article 2(1)(h) of Directive 2003/71/EC (the Prospectus Directive), being a legal entity which issues or proposes to issue securities.

<sup>5</sup> See response to Q7 for detail on related third parties.

<sup>6</sup> Article 8d(1) of Regulation (EC) No 1060/2009 as amended by CRA III.

<sup>7</sup> Article 8c(1) of Regulation (EC) No 1060/2009 as amended by CRA III.

<sup>8</sup> “structured finance instrument” is defined in the CRA Regulation as “a financial instrument or other assets resulting from a securitisation transaction or scheme referred to in Article 4(36) of Directive 2006/48/EC”. Under Article 4(36) of Directive 2006/48/EC (the “**Banking Consolidation Directive**”), “securitisation” means “a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranching, having the following characteristics: (a) payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures; and (b) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.”.

<sup>9</sup> [http://www.esma.europa.eu/system/files/esma\\_cra\\_market\\_share\\_calculation.pdf](http://www.esma.europa.eu/system/files/esma_cra_market_share_calculation.pdf)

<sup>10</sup> [http://www.esma.europa.eu/system/files/esma\\_cra\\_market\\_share\\_calculation.pdf](http://www.esma.europa.eu/system/files/esma_cra_market_share_calculation.pdf)

<sup>11</sup> Moody’s Investors Service Cyprus Ltd, Moody’s France S.A.S., Moody’s Deutschland GmbH, Moody’s Italia S.r.l., Moody’s Investors Service España S.A. and Moody’s Investors Service Ltd. are each registered with ESMA.

---

<sup>12</sup> Fitch France S.A.S, Fitch Deutschland GmbH, Fitch Italia S.p.A., Fitch Polska S.A., Fitch Ratings España S.A.U., Fitch Ratings Limited and Fitch Ratings CIS Limited are each registered with ESMA.

<sup>13</sup> Standard & Poor's Credit Market Services France S.A.S., Standard & Poor's Credit Market Services Italy S.r.l. and Standard & Poor's Credit Market Services Europe Limited are each registered with ESMA.

<sup>14</sup> For more detail on credit rating activities and ancillary services see response to Q4.

<sup>15</sup> For example, see <http://www.dbrs.com/research/261876/german-residential-funding-2013-2-limited.pdf>.

<sup>16</sup> For example, see <http://www.dbrs.com/research/253030/auto-abs-2012-3-fta.pdf>.

<sup>17</sup> For example, see <http://www.dbrs.com/research/242604/mesena-clo-2011-1-b-v.pdf>.

<sup>18</sup> Milbank, Tweed, Hadley & McCloy LLP, as deal counsel, advised Pramerica Investment Management Limited in its capacity as investment manager.

<sup>19</sup> "Originator" is defined in the CRA Regulation as an originator as defined in point (41) of Article 4 of the Banking Consolidation Directive, being "(a) an entity which, either itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised; or (b) an entity which purchases a third party's exposures onto its balance sheet and then securitises them".

<sup>20</sup> "Sponsor" is defined in the CRA Regulation as a sponsor as defined in point (42) of Article 4 of the Banking Consolidation Directive, being "a credit institution other than an originator credit institution that establishes and manages an asset-backed commercial paper programme or other securitisation scheme that purchases exposures from third party entities".

## ALTERNATIVE INVESTMENTS GROUP

Please feel free to discuss any aspects of this Client Alert with your regular Milbank contacts or any of the members of our Alternative Investments Practice.

If you would like copies of our other Client Alerts, please visit our website at [www.milbank.com](http://www.milbank.com) and choose "Client Alerts" under "News."

This Client Alert is a source of general information for clients and friends of Milbank, Tweed, Hadley & McCloy LLP. Its content should not be construed as legal advice, and readers should not act upon the information in this Client Alert without consulting counsel.

© 2014 Milbank, Tweed, Hadley & McCloy LLP.

All rights reserved.  
Attorney Advertising.  
Prior results do not guarantee a similar outcome.

## NEW YORK

One Chase Manhattan Plaza, New York, NY 10005

---

Elizabeth Besio Hardin	<a href="mailto:ehardin@milbank.com">ehardin@milbank.com</a>	+1-212-530-5037
Deborah Festa	<a href="mailto:dfesta@milbank.com">dfesta@milbank.com</a>	+1-212-530-5540
Jay Grushkin	<a href="mailto:jgrushkin@milbank.com">jgrushkin@milbank.com</a>	+1-212-530-5346
Douglas Landy	<a href="mailto:dlandy@milbank.com">dlandy@milbank.com</a>	+1-212-530-5234
Eric Moser	<a href="mailto:emoser@milbank.com">emoser@milbank.com</a>	+1-212-530-5388
Albert Pisa	<a href="mailto:apisa@milbank.com">apisa@milbank.com</a>	+1-212-530-5319
Blair Tyson	<a href="mailto:btyson@milbank.com">btyson@milbank.com</a>	+1-212-530-5233
John Williams	<a href="mailto:jwilliams@milbank.com">jwilliams@milbank.com</a>	+1-212-530-5537

## LOS ANGELES

601 South Figueroa Street, 30th Floor Los Angeles, CA 90017

---

Deborah Festa	<a href="mailto:dfesta@milbank.com">dfesta@milbank.com</a>	+1 213-892-4400
---------------	--	-----------------

## LONDON

10 Gresham Street London EC2V 7JD England

---

James Warbey	<a href="mailto:jwarbey@milbank.com">jwarbey@milbank.com</a>	+44-20-7615-3064
--------------	--	------------------