Comment

of the German Insurance Association (GDV)

on the ESMA Call for evidence on
Availability and use of credit rating information and data
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The German insurance association GDV welcomes the opportunity to comment on ESMA's call for evidence on the availability and use of credit rating information and data. As one of the largest institutional investor group's insurers are regular users of credit rating data for investment management, risk management and regulatory reporting as well as accounting purposes. As a matter of fact external credit rating information is indispensable for European insurers.

From discussions with our members as well as direct interaction with credit rating agencies (CRAs) we are concerned by the business conduct of the three largest US-based CRAs S&P, Moody's and Fitch. It is our view that these CRAs currently take inadequate advantage of their oligopoly-like market position to the detriment of institutional investors and overall capital market efficiency. Our main comments are:

- Due to their all-dominant market position institutional investors are de facto forced into license agreements with the three largest US-based CRAs S&P, Moody's and Fitch.
- Given their monopolistic market power the afore-mentioned CRAs enforce excessive year-on-year fee increases between 5 percent and 25 percent for credit rating information on institutional insurers.
- Once licensed to other CRA products or services it is almost impossible to terminate such products, as CRAs stick to their revenues and ask for higher fees for ratings only instead of ratings in combination with research services (bundle agreements).
- Given the current market practices GDV strongly believes that the commercial issues surrounding CRA licensing practices should be firmly addressed by ESMA and the EU Commission.
- GDV therefore recommends revising the CRA III regulation to clarify that all CRA subsidiaries fall under the scope of the CRA III regulation. A strict and transparent cost regulation of rating information services that are not marketed by the analytical units of the CRA groups is seen as necessary to stop inadequate market practices by CRA groups.

7.1.2 Activities in which credit ratings are used as 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:

Insurers use credit rating information in the investment decision making process to assess the solvency of issuers and the credit quality of individual bonds and other financial instruments. In the risk management process credit ratings are used to assess the credit quality of the investment portfolio and to check whether concentration exposures and limits per rating class are fulfilled according to internal guidelines. The Solvency II framework requires insurers to transmit credit ratings for each financial instrument to the national regulatory body BaFin. In detail:

- Market risk calculations under Solvency II pillar 1 assessments (spread and default risk module)
- Calculate matching adjustment
- Calculation of spread and default risks in the context of pillar 2, ORSA
- Scenario analysis and regulatory stress testing
- Identification and monitoring of internal mix rates and limit settings
- Defining guidelines and benchmarks for asset manager mandates as well as in the development of strategic asset allocation
- In asset management assessment of the risk profile of individual issuers
- Reinsurance risk management
- Internal investment reporting (ad hoc, monthly, quarterly)
- Analyst presentations / reporting
- Regulatory reporting (e.g. quarterly Solvency II pillar 3 QRT reporting, S.06.02), SFCR, RSR,
- Annual reporting and IFRS accounting: financial disclosures, calculation and disclosure of impairment provisions, credit quality of debt securities.

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

Yes, please see above general answer to Q5. Insurers are legally required by Solvency II to constantly measure, manage, monitor and report their main risk positions. This is in particular true for market risks on the investment side and for the internal management of the portfolio, for reinsurance risk management as well as for valuation and risk analysis in the overall risk management. To comply with these obligations, credit ratings have to be used and there is no feasible alternative to it. Solvency II Delegated Regulation (EU) 2015/35 Art. 4 rules, that insurers are only allowed to use credit ratings of a certified ECAI.

Moreover, insurers have to fulfill regulatory reporting obligations in relation to the calculation of capital requirements and the reports of Solvency II's pillar 3. To comply with these obligations, credit ratings have to be used. Other regulatory provisions that require the use of credit ratings include the MaGo as well as BaFin circular 11/2017.

Moreover, a regulatory requirements also exists in the context of IFRS accounting with respect to financial disclosures, calculation and disclosure of impairment provisions and the 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. Activities described above are a prerequisite to be allowed to run insurance business in the context of investment decisions, for reinsurance decisions as risk reduction/sharing as well as for valuation and risk analysis in risk management:

- Assessment of insurers' financial strength is in the interest of shareholders, brokers and customers.
- Monitoring of insurers' own credit quality of investments to be compliant with internal guidelines, strategies, ALM objectives. Results of credit risk assessments and measurements such as credit ratings, credit risk capital for a portfolio and credit concentration limits must be considered appropriately in strategic decisions (e.g. the Planning Dialogue and Strategic Dialogue Process on legal entity level and group level), as well as tactical and day-to-day decisions.
- Assessment of the financial strength of reinsurance counterparties.
- Compliance with regulatory reporting requirements.

About 80 percent of German insurers' portfolios are allocated to fixed income, credit ratings are next to duration the most important KPI to steer the portfolio.

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

Clearly indispensable in order to fulfill the above mentioned legal and regulatory requirements. Credit ratings provide an independent and market observable view that satisfies internal and external requirements and allow like-for-like comparisons. For mandating asset managers in the listed fixed income space credit ratings are key.

Internal ratings are not available for most insurers since the regulatory requirements are far too high. But even insurers with internal models are to some extend dependent on external credit rating information since internal ratings are often not fully equivalent in terms of amount and detail of processed information, model quality and timeliness. Moreover, even under a full internal model approach the Solvency II minimum capital requirement has to be calculated with external ratings.

(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 organsation between operating entities and (group) functions and has to be transmitted 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 (realtime / lag of less than 15 minutes / daily / monthly / quarterly / other)?

Depending on the concrete purpose and the analysis being performed (portfolio management, risk management, financial and regulatory reporting) real time, daily, monthly and quarterly. For reporting purposes quarterly updates are sufficient.

(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 (e.g. .txt, .xml, .csv, .xlsx). The interface is usually chosen according to the CRA's specifications.

(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…)?

- Instrument credit rating
- Issuer credit rating
- Ultimate parent credit rating

- Sovereign credit rating
- ISIN of the rated instrument
- LEI (or CUSIP) of the issuer of the rated instrument and parent issuing entities
- LEI of the credit rating agency
- Credit rating office name
- Date of the rating
- EU endorsement status
- Rating outlook
- Rating type e.g.:
    - Issuer Rating
    - Long Term Issuer Default Rating
    - LT Foreign Currency Issuer Credit Rating
    - LT Local Currency Issuer Credit Rating
    - LT Foreign Currency Issuer Default Rating
    - Foreign Currency Issuer Rating
    - Senior Secured Debt Rating
    - Senior Unsecured Debt Rating
    - Subordinated Debt Rating
    - Junior Subordinated Debt Rating
    - Senior Subordinated Debt Rating
    - Public sector covered bonds rating (Oeffentliches Pfandbrief Rating)
    - Mortgage covered bonds rating (Hypotheken Pfandbrief Rating)
    - Senior Secured Debt Rating
    - Senior Secured Debt Rating - Cedulas Hipotecarias
    - Senior Secured Debt Rating – Mortgage covered bonds (Pfandbriefgesetz)
    - Senior Secured Debt Rating - Obligations Foncieres
    - Senior Secured Debt Rating - Obligasjoner med fortrinnsrett
    - Cummulative Preferred 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, measurement of credit exposures (e. g. reinsurance) and to comply with regulatory and accounting requirements some but not all insurers use CRA ratings reports, rating criteria, research papers, data models and press releases.

Information about the rating agencies and rating models e.g. data models and methodology are important for insurers' Solvency II model frameworks (e.g. validation) as well as for other accounting and reporting processes. Press releases, rating reports and research papers are required and necessary information for investments decisions as well as monitoring of credit exposures including active credit investments and other exposures (e.g. reinsurance).

Moreover, such information is also often used to comply with the Credit Rating Agency Regulation (EU) 462/2013 (CRA III regulation) (assessments and plausibility checks on external credit ratings).

(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.).

The coverage needed comprises all rated instruments such as bearer bonds, registered bonds and Schuldscheindarlehen in the investment portfolio, traded and non-traded. While ratings are in particular needed for euro denominated instruments since they account for the largest portion of instruments in insurers' portfolios, there is generally no limitation to certain regions, markets and/or instrument types. For instruments where there is no issue rating available, the rating is often derived from the issuer rating. Therefore issuer as well as ultimate parent issuer ratings are needed as well.

Ratings are also needed for reinsurers in the context of reinsurance risk management.

(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

Given the large and diversified investment portfolios, insurers are dependent on ECAI CRAs with 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 such as for example German covered bonds (Pfandbriefe), respective instruments are almost exclusively rated by S&P, Moody's and Fitch. This situation is often referred to as an oligopoly by our members. Accordingly, insurers are de facto dependent on these three credit rating agencies to fulfill and execute the activities described under Q5.

Additionally, some insurers use CRAs such as Scope and DBRS, but coverage of these CRAs is currently not seen as sufficient to adequately comply with the described regulatory and risk management purposes for which credit ratings are needed.

7.1.3 CRA's 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.

The public websites are not often used by insurers, but only occasionally by some insurers. The main reason is that CRA websites do not allow for an automated and free-of-charge provision of data in a structured data format.

Some insurers do not use ratings published on the CRAs' websites at all since the terms of use require the companies to enter into a license agreement with the CRA to use the ratings in potentially any way. Moreover, the data which is freely provided includes only ratings from the last seven days and no data download function or sorting by bonds of portfolio and by date of the rating is offered. Finally, insurers generally need ratings not only from one of the top-3 CRAs but from at least two or even all three CRAs.

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?

Insurers are mainly not aware of such changes. To our understanding CRAs claim that intellectual property laws prohibit the use of credit ratings both for insurers' internal use and regulatory reporting. Hence, CRAs claim that internal use and use for regulatory reporting is only allowed when the company has entered into a license agreement with the CRA. However, our own legal assessment is, that users should be able to use such rating information from the CRAs' websites without the obligation to enter into a license agreement for the following reasons:

- As far as the user of the rating results is located in Germany, the territorial principle applies and there is no automatic recourse to US law.
- Rating results, in their capacity as data or information, do not enjoy independent protection under German copyright law.

- The databases of rating agencies can be viewed as databases in the sense of section 87a (following) German copyright law (UrhG). However, there is no interference with any database rights of the rating agencies unless the ratings are taken directly from a database / website operated by the rating agency. The investment protection of a database creator extends according to section 87a (following) German copyright law both to the database in its entirety and to its essential parts. However, according to the jurisprudence of the German Federal Court of Justice, an “essential part” of a database is not assumed if only 10 percent of the data records are used. In most cases insurers would use less than 10 percent of CRA’s data records.
- In our opinion, using the rating results also does not constitute a breach of the integrity rights (Lauterbarkeitsrecht) or the competitions laws, so that no claims for compensation or the conclusion of license agreements for the use of ratings can be derived from this.

Moreover, the three large US-based CRAs are using their oligopoly-like business position to enforce regular and significant increases in the cost of these licenses.

More information about the situation of public available credit ratings can be found here (https://www.law.ox.ac.uk/business-law-blog/blog/2018/03/making-credit-ratings-data-publicly-available)

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 also in the view of the CRA without a license agreement for internal (risk management) purposes and for regulatory (Solvency II) purposes. The highest subsequent priority is seen in establishing CRA websites that allow for export options with an automated and free-of-charge provision of rating data in a structured data format. Other positive changes:

- Rating information should be available on the website without the necessity to create an account with the CRA
- Issuer names should be harmonized across rating agencies ("true legal name")
- LEIs should be made available, allowing for more robust and efficient data processing
- The supply of all available ratings per issuer would be helpful.

- A website in local language would be seen positive especially for smaller and medium sized insurers
- Finally, some insurers mentioned that a publication of credit research reports free of charge would also be helpful.

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?

Very Positive. Under the pre-condition that rating information would be freely usable for internal and regulatory purposes, available in a timely period and with efficient processes that allow for automated provision of rating data in a structured data format, many insurers highlighted that with these changes they would be in a position to terminate existing license contracts with CRAs and safe significant annual fees.

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

Positive.

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

Enabling insurers and their asset managers to distribute rating information to clients in an electronic format free of charge without obligation that clients have to have a contract in place with CRAs. ESMA and CRAs should clarify that defined rated issue data obtained from the CRA's websites directly or indirectly through third party distributers can be used free of charge and without obligation to enter into an additional license. Also, free use of rating data for information and reporting should be independent of the format used. Moreover, the use of derived or processed data (e. g. CQS) needs to be included in the definition of fee and license free usage.

Additionally, If rating reports or the information on migration matrices and recovery rates were freely available, insurers would save time and gain important credit information in the data used with a view to the matrices and recovery rates. Currently, this information is not freely accessible for the current year, but only T-1.

(D) Other?

No answer.

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.

No answer.

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 data-feed as your primary source of rating information.

The main reason for using a paid data feeds is for operational reasons as well as the necessary frequency of updates and the granularity of the data. The provision of rating information is implemented differently by our members. Data suppliers do not allow insurers to download rating data unless insurers have signed a license agreement with the CRAs and supply evidence thereof. All data providers like Bloomberg, Reuters/Refinitiv and Factset have such limitations included in their actual terms of use, which new clients have to sign to get the service and require the same proof. Data providers also inform the CRAs, at least on request, if a client is demanding access to and/or is downloading rating data.

Several members use exclusively Bloomberg to receive the needed rating information from S&P, Moody’s and Fitch via paid data feeds. Through the paid data feed the investor receives a uniform data feed with few interfaces that is frequently updated.

The CRA Scope directly provides rating information via a free of charge data feed to investors. However, one member stressed that a data feed of Scope rating information via Bloomberg would come along with additional costs for users since Scope falls in a different Bloomberg category than the three US-based CRAs. Bloomberg has so far not been willing to set Scope in the same category as S&P, Moody’s and Fitch despite respective requests by Scope and the insurer.

For certain issuers that are not externally rated, private ratings are mandated and for some instruments and issuers internal ratings are carried out.

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?

- Rating information from S&P, Moody's and Fitch via Bloomberg: Bloomberg Data License.
- Rating information from S&P: S&P Global Market Intelligence LLC: RatingsDirect + RatingsXpress
- Rating information from Moody's: Moody's Analytics UK Limited: Corporate and Structured Finance Instrument Site Daily + Corporate and Structured Finance Organization Site Daily
- Rating information from Fitch: Fitch Solutions Ltd: CRD-Enhanced – Corporate Finance
- Rating information from Fitch: DBRS Limited: Access to Data Obtained
- Rating information from Scope: ScopeOne API-data-feed.
- Rating information from service provider WM Datenservice: via SFTP.

(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 paid data feeds sometimes allow a limited internal and external (regulatory) use of rating information. However, even in case of a license with a third-party provider such as Bloomberg the respective individual license agreements with the CRAs have to be considered, since they often strictly limit the use of information.

Generally, rating providers restrict usage by business cases. Each business case has to be licensed separately and comes along with additional costs e.g. regulatory usage for Solvency II, regulatory usage for IFRS, usage in non machineable format for client reporting etc. A group license with respective costs allows internal usage depending on licensed entities, were each business line costs extra (e.g. insurance, p&c, asset management, banking). Transmission of data outside the company requires a costly distribution license.

(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)?

Members responded: real time and daily. Few insurers without paid data feeds update rating information manually on a monthly basis.

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

Structured data format (TXT, XML, CIV, CSV, proprietary Bloomberg format / pipe separated flat file or other).

(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…)?

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.)?

Please refer to answer to Q5 (I). Globally, all asset classes, ratings have to be European endorsed.

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

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.)?

This is true for some but not all insurers. We are concerned by the business conduct of CRAs when offering their services. Once licensed it is almost impossible to terminate such products, as the providers stick to their revenues and ask for higher fees for ratings only instead of ratings in combination with research services (bundle agreements).

(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.

Please refer to individual answers by member companies. Unfortunatley, unlike exchanges under MiFID CRAs are not required to publish pricelists. We are aware from our conversations with members that fees are significant and have been increasing in many cases excessively year-on-year since Solvency II implementation (usually at least in excess of 5 percent, often two-digit p. a.). Even when license agreements are in place CRAs regularly try to charge additional fees for new services. Large and medium sized insurance groups claimed that rating providers insist in bundling other services with rating agreements (for example ESG services) and hence sometimes force annual fee increases between 15 percent and 25 percent on insurers.

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.

Member feedback was that insurers currently usually do not use the ERP. Main reasons for this are:

- Rating information is not retrievable in a structured manner. Filter options are missing, e.g. filter functionality at the CRA level.
- There is legal uncertainty regarding the free-off charge usability of the ERP. Before accessing the ERP users have to accept per click that the data can be „subject to third party proprietary rights". Therefore, user suspect 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.

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?

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. In order to consider the ERP the following issues have to be resolved:

- Legal uncertainties with respect to possible obligation to enter in separate license agreements with CRAs do no longer prevail and the data is free to use.
- Better usability:

  - rating information of defined CRAs is retrievable as collective calls /bulk orders / downloads in an automated and structured manner for example in CSV, XLS format
  - More frequent and more timely updates, at least monthly
  - Content mapped to CRA agnostic rating scale not CQS level
  - Improved traceability of data, definition of classification systems used, treatment of multiple issuances by the same issuer
  - More granular sector classifications
  - Legal or contractual seniority per issuer and /or issue
  - Ability for comparable analysis of CRAs' ratings overlap
  - Ability to adjust time periods (not only 1 January and 1 July)
  - Information, where the rating was assigned, since auditors and Solvency II regulation require only EU ratings to be used
  - Historic rating information by date
- Generally, data quality should not be inferior compared to status quo od paid data feeds (please also refer to Q5 in this respect).

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 favor of such changes:

(A) Freely downloadable in CSV format?

Members would see this change as very positive. CSV format allows an efficient processing of data. Together with the points mentioned under Q14 insurers would be able to exclusively switch to the ERP. Switching to ERP with continued free access would result in significant annual savings for companies. Also, given the regular license fee increases of 5 percent to 25 percent p. a. this would reduce financial costs and dependencies significantly.

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

Members would see this change as positive. Potentially allowing batch processing.

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

Legal uncertainties with respect to possible obligation to enter in a license agreement have to be clarified.

(D) Other?

No answer.

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. 7.1.6 Additional relevant information and evidence

No negative impact identified above.

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.

From discussions with our members as well as directly with the three US-based CRAs S&P, Moody's and Fitch it is our view that the three US-based CRAs take excessive advantage of their oligopoly-like market position to the detriment of institutional investors who are dependent on ratings for risk management and regulatory reasons. Due to their dominant market position institutional investors are de facto forced into license agreements with these three CRAs despite the respective ratings have been fully paid for and have been made public on websites and in press releases.

GDV therefore strongly believes that the commercial issues surrounding CRA licensing practices with regular excessive fee increases need to be firmly addressed by ESMA and the EU Commission.

Moreover, the discussions between the GDV and S&P, Moody's and Fitch 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. We therefore recommend to revise CRA III in order to clarify that all CRA subsidiaries fall under the scope of the CRA III regulation. A strict and transparent cost regulation of rating information services that are not marketed by the analytical units of the CRA groups but by separate subsidiaries would be urgently advisable. Moreover, transparency on pricing should be improved significantly.

Berlin, 29 July 2020