Joint association statement on the importance of credit ratings in the EU corporate bond transparency regime

4th December 2024

Overview

This statement is supported by the following financial markets Trades Associations ("the Associations") on behalf of their members active in the EU bond markets, including sell side, buy side, and financial market infrastructures: the Association for Financial Markets in Europe (AFME), BVI (German Investment Funds Association), Bundesverband der Wertpapierfirmen (bwf), the European Fund and Asset Management Association (EFAMA) and the International Capital Markets Association (ICMA).

As ESMA's review of EU's post-trade transparency for bonds enters its final stages the undersigned Associations strongly reiterate the importance of the incorporation of credit ratings in underpinning the success of the EU post-trade transparency framework for corporate bonds.

Distinguishing between investment grade (IG) and high-yield (HY) corporate bonds is an essential element that provides for greater transparency in more liquid bonds whilst balancing the need to provide protection for those bonds where overly prompt dissemination of trade information has the ability to negatively impact market liquidity.

Other sophisticated bond markets also calibrate transparency for corporate bonds according to the credit rating of the issuer. Not adopting a similar methodology would put EU corporate bond markets at a disadvantage globally.

The associations therefore urge policy makers to ensure that the European Union will remain competitive in the global fixed income markets, preserving and potentially expanding existing liquidity in EU bond markets, which in turn will continue to ensure issuers can finance their investment needs in the most effective way. It is clear that there are precedents for using credit ratings, not just across jurisdictions but also under other EU regulations.

Use of credit ratings for the calibration of transparency for corporate bonds

- Why the need for credit ratings?

The susceptibility of corporate bonds to **price volatility** varies based on their credit rating. High Yield bonds (i.e. bonds that meet lower credit quality standards) are innately more volatile in price than Investment Grade bonds (i.e., bonds of higher credit quality). This, consequently, creates greater sensitivity to undue risk potentially caused by overly early publication of trade details which, in turn, creates greater sensitivity and volatility in risk price provision caused by the same. This necessitates different levels of protection for those instruments that have greater price volatility. **Having a distinction between IG/HY corporate bonds allows for more tailored transparency levels for instruments with different price volatility profiles**.

Association for Financial Markets in Europe
London Office: Level 10, 20 Churchill Place, London E14 5HJ, United Kingdom T: +44 (0)20 3828 2700
Brussels Office: Rue de la Loi 82, 1040 Brussels, Belgium T: +32 (0)2 883 5540
Frankfurt Office: c/o SPACES – Regus, First Floor Reception, Große Gallusstraße 16-18, 60312, Frankfurt am Main, Germany
T:+ 49 (0)69 710 456 660
www.afme.eu

Credit rating is a criterion used by TRACE in the US for several years without difficulty; in the UK the FCA has just adopted credit rating as an important element for the calibration of the FCA's proposed transparency models.

AFME are confident that this approach in other jurisdictions can provide sufficient reassurance for regulators in the EU as well, regarding the feasibility of using credit ratings and can better help achieve the goal of competitiveness of EU capital markets with other leading global financial centres

- Wide support for use in transparency framework and evidence of their current use in EU regulation

The **European Commission expert stakeholder** group on equity and non-equity market data quality and transmission protocols have also recommended in their Report on bonds (available here) that ESMA should consider the distinction of IG vs HY corporate bonds. Similarly, ESMA's own **Securities & Markets Stakeholder Group (SMSG)** in its advice to ESMA also recommend the distinction between IG and HY to result in a more refined calibration approach (further details here).

It should be noted that the **ECB rely on credit rating** as part of its assessments in the context of their prudential regulation and monetary policy powers. Specifically, the Eurosystem credit assessment framework relies on credit ratings from external credit assessment institutions (ECAIs). The different credit rating grades are mapped to a harmonised rating scale in order to make the ratings comparable across systems and sources, with 1-3 representing investment-grade status while steps 4-5 are for non-investment grade status.

In addition, **at the EU level there is already a credit assessment framework based on External Credit Assessment Institutions (ECAIs)** that applies in the context of various EU regulations, including the CRR and EMIR, market participants are mandated to conform with that.

We further note that ESMA already operate a potential source of the relevant data in the form of the European Rating Platform (ERP) which incorporates ratings data from all authorised credit rating agencies, including the 3 most globally recognised ones.

Given ESAs already apply the mapping table of ECAIs' credit assessments pursuant to implementing CRR regulation, this could effectively address any operational issues that might arise when using credit ratings as part of the MiFIR post-trade transparency deferral calibrations, if ESMA were willing to host a golden source (flag IG/HY per ISIN) available to the industry.

Another option would be to leave the implementation to the industry (as the FCA and FINRA have done) with the determination defined at the level of investment firms, APAs and trading venues.

Victoria Webster, Managing Director, Fixed Income, AFME

Dr Thorsten Freihube, Director, Market Practice & Regulatory Policy, bwf

Rudolf Siebel, Managing Director, BVI German Investment Funds Association

Susan Yavari, Deputy Director, EFAMA

Andy Hill, Managing Director, Co-head of Market Practice and Regulatory Policy, ICMA

Notes:

1. **AFME (Association for Financial Markets in Europe)** promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information, please visit the AFME website: www.afme.eu.

2. **The Bundesverband der Wertpapierfirmen e.V. (bwf)** protects and promotes the common professional interests of Germany's investment firms on a national, European and global level. The association assists and informs its members in all matters that concern them in connection with their activity as licensed and regulated investment firms. The bwf furthermore works closely together with national and international industry associations of the banking and capital markets sector.

3. **BVI** represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

4. **EFAMA** is the voice of the European investment management industry, which manages around EUR 30 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors. Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities. EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the authoritative EFAMA Fact Book. More information is available at www.efama.org

5. **International Capital Market Association (ICMA)** promotes well-functioning cross-border capital markets, which are essential to fund sustainable economic growth. It is a not-for-profit membership association with offices in Zurich, London, Paris, Brussels, and Hong Kong, serving around 620 members in almost 70 jurisdictions globally. Its members include private and public sector issuers, banks and securities dealers, asset and fund managers, insurance companies, law firms, capital market infrastructure providers and central banks. ICMA provides industry-driven standards and recommendations, prioritising three core fixed income market areas: primary, secondary and repo and collateral, with cross-cutting themes of sustainable finance and FinTech and digitalisation. ICMA works with regulatory and governmental authorities, helping to ensure that financial regulation supports stable and efficient capital markets.