Wholesale Data Market Study

Annex 3: Credit Ratings Data

29 February 2024

Contents

1 Introduction

1.1 This annex supplements Chapter 4 of the Wholesale Data Market Study Report, which summarised our findings in the UK market for the access, licensing, and distribution of credit ratings data.

1.2 This document provides a more detailed analysis of the CRA issuer services and data feeds markets, expanding upon concepts and evidence discussed in the Final Report. It provides a fuller description of our evidence sources, analytical approach, and assessment of how competition works, based on the consolidated evidence we have collected and analysed.

Rationale and approach to evidence gathering

1.3 Our Terms of Reference set out our intention to gather information to assess whether the markets in scope of the market study are working well. This included a broad range of relevant stakeholders, including suppliers of benchmarks, indices and credit ratings data, Market Data Vendors (MDVs) and users of these services and data.

1.4 The findings in this annex are based on information gathered specifically for the market study, structured discussions with market participants, and a comprehensive literature review.

1.5 Evidence sources used include:

- Industry responses to the FCA's 2020 Wholesale Data Call for Input and responses to the August 2023 Update Report
- Structured discussions with CRAs and their data affiliates
- Information request responses from UK CRAs, their data affiliates, and MDVs
- Meetings with US and UK credit score providers
- Meetings with international financial regulators and trade associations
- An online survey of users of issuer services and users of credit ratings data
- Responses to FCA's Trade Data Review user survey
- Data on UK debt issuances sourced from Bloomberg
- A literature review of publicly available documents

Methodology

Qualitative information

1.6 We received qualitative information from 9 CRAs registered or certified to offer issuer services in the UK. This information includes their product offering, business strategy, relationships with customers and redistributors, terms and conditions, as well as views on the competitive landscape and regulatory environment.

1.7 For data feed services, information was gathered from CRAs who directly provided data feeds, and the data affiliates of the largest 3 CRAs.

Financial analysis

1.8 The financial analysis is based on a sample of 14 firms – 9 CRAs offering issuer services in the UK and 5 firms offering data feed services to UK domiciled customers.

1.9 Assessing profitability to understand the competitive dynamics within a sector can be challenging, due to the quality and availability of data. We have explained in detail such considerations in the Methodology section of the Financial Analysis Annex.

Transaction level data

1.10 Transaction data was requested from data feed providers over a 6-year time horizon – from 2017 to 2022. We received transaction data from 5 data feed providers. The data includes, where available, information on revenue generated at the client, contract, and product level. We analysed the transaction level data to inform our understanding of drivers of revenue and product pricing trends, and the extent and nature of supplier practices and behaviour such as price discrimination. We refer to findings from the analysis of the transaction level data throughout as 'transaction level analysis'.

1.11 While the data we received included information on revenue broken down at the client, contact and product level, it was not consistently available across all providers. As such, our analysis often focuses on metrics that allow consistent comparisons across providers and time. In particular, our analysis focuses on customers' total expenditure with a supplier rather than product pricing. This expenditure reflects both changes in the total products purchased by clients, and changes to the price of those services.

1.12 Where relevant, we focus analysis on a cohort of customers who stay with their data feed provider over a given period.

User survey

1.13 To gather information from customers of both issuer services and data feeds, we issued a survey to a range of potential users to understand what products and services they bought, how they access them, how they use them within their business, and the criteria they consider when choosing a particular product and provider.

1.14 We were also interested in the frequency of multi-sourcing, issuers who acquired credit ratings from multiple CRAs, and investors who purchased data feeds to cover the ratings of multiple CRAs.

1.15 We also sought views on users' procurement processes, and their ability to compare, negotiate and switch to alternative products or providers. We sought users' views and experiences of pricing, terms and conditions, quality and the impact of changes in these on their own product offering.

1.16 The survey was separated into five sections. Section 1 requested information from users about their business, industry, and the costs of purchasing the products and services within scope of the market study. Sections 2 to 5 asked questions to users of benchmarks, credit ratings issuer service, credit rating data and MDVs respectively.

1.17 Survey respondents were encouraged to only provide feedback to the sections relevant to them. In total we received around 140 survey responses covering a range of industries and users, including around 40 users of issuer services, and around 60 users of credit ratings data (referred to in this annex as data feeds). Issuer services are typically purchased by 'sell side' issuers of debt, and data feeds are typically purchased by 'buy side' purchasers of debt.

1.18 Not all respondents responded to all survey questions. The total number of respondents relates to those who provided feedback to at least one question. The total number of responses to specific questions, and relevant percentages, can be different if some users did not respond to that question.

Literature Review

1.19 Due to the alignment with EU CRA regulation (EU CRAR) prior to the UK's withdrawal from the EU, this report makes extensive use of various European Securities and Markets Authority (ESMA) publications relating to CRAs. This includes various publications evaluating the market share of CRAs, issuers' use of challenger CRAs, the regulatory use of credit ratings by investors, the fees charged for credit ratings data, and proposals for alternative measures of credit risk.

1.20 Additionally, this report makes use of documents published by the Bank for International Settlements, European Banking Authority, European Central Bank, European Commission, European Parliament, Financial Stability Board, IOSCO, OECD, SEC, and SIFMA.

Public data on UK debt instruments

1.21 Finally, we conducted analysis on ratings coverage of CRAs by accessing data on UK debt instruments from Bloomberg. The scope of this data was the largest 500 corporate bond issuances as of December 2023.

Scope and limitations

1.22   Capital markets are global in nature, and many institutional investors who rely on credit ratings have global operations, regulatory obligations, and investment strategies. The UK's debt capital markets are highly international, with a significant volume of business activity involving cross-border transactions. Many, if not most, UK data feed users have global operations and can purchase data feeds from suppliers based outside of the UK.

1.23   Whilst the scope of this report is limited to the UK market, it is acknowledged a fundamental driver of the value of CRAs to market participants is their international presence. We estimate that approximately 95% of public ratings issued by CRAs and included in data feeds, relate to international assets which are not created or monitored by UK CRAs. However, as discussed in 3.9-3.10, international ratings are commonly still endorsed by UK CRAs.

1.24   CRAs and their data affiliates consistently stated they did not view the UK as a self-contained market, with business strategies typically structured at the European or international level. However, market participants did state that UK market dynamics were broadly reflective of the international CRA market.

Use of terminology

1.25   This document attempts to balance an accurate explanation of complex concepts with accessibility to readers who do not have a technical background in credit ratings, capital markets, or financial regulation.

1.26   This document makes use of the following terms which may not be aligned with industry terminology:
- Regulated credit rating activities which result in a public credit rating are referred to as 'issuer services'. This includes unsolicited ratings and public ratings created under the investor pays model, which were found to be a negligible component of the UK market.
- 'Credit ratings data' is any database of public credit ratings which is available for free or as part of a data feed service.
- 'Data feeds' are any service which include a database of public credit ratings and the associated technology platforms for accessing the database. It additionally includes the contractual licensing of credit ratings for regulatory and commercial purposes.
- 'Data affiliate' is an affiliate of a CRA that sells data feeds. The activities of these entities are typically unregulated. Market participants generally referred to regulated CRAs and their data affiliates synonymously as 'CRAs'. We refer to data affiliates in places where the distinction is necessary to understand the mechanics of the UK market.
- 'Investors' refers to institutional purchasers of debt instruments and market intermediaries who use credit ratings for regulatory or commercial purposes. This includes commercial banks, investment firms, investment platforms, insurers, reinsurers, collective investment scheme managers, alternative investment fund managers, broker-dealers, and central counterparties.

- 'Issuers' refers to organisations that issue debt instruments on capital markets. This includes financial institutions, non-financial corporates, and government entities.
- The phrase 'market participants' is used when referring to both investors and issuers.
- 'Users' refers to institutional investors who have purchased data feeds.
- CRAs are deemed to have issued a public credit rating when the credit rating has been published on a CRA's website or publicly distributed by other means.
- In paragraphs where use of the word 'issue' could cause confusion with debt issuances or issuers, credit ratings are instead referred to as being 'created' or 'maintained' by CRAs.

Structure of this document

1.27   This Annex is structured as follows:
- Chapter 2 provides an overview of credit ratings
- Chapter 3 provides an overview of issuer services
- Chapter 4 provides an overview of data feeds and the broader distribution of credit ratings data
- Chapter 5 sets out the competitive dynamics we observe in the credit ratings data feeds market
- Chapter 6 examines the market outcomes we observe
- Chapter 7 focuses on commercial practices and the impact on end users.

2 Market Overview

Credit rating definition

2.1 Globally, CRAs are subject to regulation aimed at ensuring the integrity, transparency, and accuracy of ratings. Regulatory frameworks in the US, UK and European Union are aligned with principles developed by the International Organization of Securities Commissions (IOSCO).

2.2 The definition of credit rating used in this report is aligned with the regulatory definition outlined in UK CRA Regulation (UK CRAR). This is in turn aligned with the IOSCO definition, and analogous with that used in other developed markets including North America and the European Union.

2.3 A credit rating is an independent opinion of the probability that a financial instrument or issuing organisation can pay back its debt obligations in full and on time. Ratings involve assessing factors impacting an organisation's financial health such as cash flow, profitability, management quality and economic outlook.

2.4 The rating process typically involves both qualitative and quantitative analysis, with the conclusion quantified using a ranking system of ratings categories, enabling comparison across debt instruments. This categorisation most commonly takes the form of letter grades, typically ranging from AAA (high quality, very low chance of default) to D (in default).

2.5 Typically, a rating will be monitored and regularly updated over the lifetime of an issuance. Most ratings are updated at least annually, or on an ad hoc basis if there is a significant event which is expected to impact credit risk, such as a company merger.

The credit rating market

2.6 Over the past 50 years capital markets have played an increasingly important role in financing for both governments and corporations. This reflects a shift from traditional bank-based lending to organisations instead issuing market-based debt instruments. Approximately 90% of global debt is issued by governments and financial institutions, with the remainder issued by non-financial corporations.

2.7 It is commonly accepted that credit ratings enhance the transparency and efficiency of capital markets by reducing information asymmetry between institutional borrowers ('issuers') and lenders ('investors') and providing a common language for all market participants to understand credit risk.

2.8 Credit ratings play an integral role in both UK and international debt markets. Ratings can be a prerequisite to an organisation issuing bonds, and to banks distributing their securities in structured product and securitisation markets.

2.9   Credit ratings and associated services are a multi-billion-pound global industry. We estimate the size of the UK credit ratings market, including issuer services and data feeds, to be approximately £390m in 2022. This reflects 5-10% of global CRA revenues. This does not include revenues generated by MDVs or other third parties who integrate ratings into their analytical services.

2.10   Globally, hundreds of thousands of organisations and financial instruments have credit ratings. We estimate that ratings of UK domiciled issuers and their issuances comprise approximately a 5% share of global public ratings by volume.

2.11   The international credit ratings market is concentrated amongst the largest 3 CRAs: Moody's Investors Service ('Moody's'), S&P Global Ratings ('S&P') and Fitch Ratings ('Fitch'), commonly referred to as the 'Big Three'. These CRAs and their regional affiliates maintain over 90% of global solicited ratings and account for a similar proportion of global revenue. The regulated UK subsidiaries of the largest 3 CRAs represented 90% of the total UK market by revenue in 2022.

The business model of CRAs

2.12   CRAs primarily generate revenue from being commissioned to rate specific organisations and their debt instruments. The most common business model for this is the 'issuer pays' model. Under the issuer pays model, organisations that issue debt instruments, such as bonds or structured finance products, pay CRAs to rate those instruments. Issuers typically obtain ratings for both their specific debt instruments and for their entire organisation. CRAs are typically paid for an initial rating, as well as for monitoring and updating the rating throughout the life cycle of a debt instrument.

2.13   A less common business model is the 'investor pays' approach where investors, rather than issuers, pay for the creation of ratings. In this model, investors might pay subscription fees or purchase individual reports which include multiple ratings. The investor-pays model was used by CRAs until the 1970s. The shift toward the issuer-pays model was partly due to the growing need for widely disseminated ratings in expanding and increasingly complex debt markets. Additionally, the emergence of technology, including the fax machine, made it increasingly difficult to stop market participants from freely distributing credit ratings.

2.14   Today, the investor-pays model is typically only used in private markets where public information is more limited, and debt securities are only available for purchase to a small group of sophisticated investors, rather than publicly available. This is commonly referred to as the private placement market.

2.15   In the past decade, CRAs have increasingly diversified their business models into data and analytics services, many of which are targeted at investors rather than issuers. We found that among the largest 3 CRAs' parent companies, the share of revenue attributable to issuer services has been declining, and in 2022 a large proportion of their revenue came from non-issuer services. These services include software for risk management, financial modelling, and economic analysis. This additionally incudes premium access channels to ratings data and associated research, and licensing data for investors to use in commercial processes. For a more

comprehensive list of services offered by CRAs, please see the IOSCO report on other CRA services available [here].

2.16 Data feeds, which are the focus of this market study, currently represent only a fraction of CRAs' data and analytics services revenue.

2.17 It is important to note that, whilst targeted at investors, data feed services are not analogous with the investor pays model for two reasons:

- Data feeds are not required to access ratings. Credit ratings available within data feeds are publicly available to investors for free.

- Data feeds do not directly fund rating activities, nor influence which individual financial instruments are rated by CRAs.

2.18 CRA typically offer analytics services, including data feeds, through separate entities to issuer services. This is in part to address concerns around conflicts of interest for regulatory compliance. In this report we typically distinguish between regulated CRAs and their unregulated data affiliates.

3 Issuer services

Introduction

3.1 The focus of our analysis is the assessment of ratings data feeds. However, it is first necessary to understand issuer services, on which data feeds fundamentally depend for their existence. We estimate that over 95% of the ratings included within data feeds are the output of global issuer services.

3.2 This chapter focuses on 4 core areas, regulation of CRAs, issuer choice of credit ratings, the decisions to acquire multiple ratings, and the resulting impact on CRA market share and market coverage. This chapter is meant to inform our assessment of data feeds in Chapters 4-7.

3.3 We start by looking at the regulation of credit ratings under the UK CRAR, which has a significant impact both on the supply of credit ratings, and the demand for issuer services from specific CRAs.

3.4 Whilst forming part of the regulatory component of issuer services, the requirements for CRAs to publish credit ratings and the inclusion of ratings in free regulatory databases are discussed in this chapter.

Regulation of issuer services

3.5 This section addresses regulation of CRAs in the UK.

3.6 In the UK, credit ratings and the CRAs which issue them are subject to UK CRAR. UK CRAR became distinct from EU CRAR following the UK's departure from the European Union in 2020. As of publication, the UK and EU CRAR remain equivalent in purpose and impact on market participants. However, it is possible that future amendments to either regulatory regime may make them less comparable.

3.7 UK CRAR applies to ratings issued by CRAs which are disclosed publicly or distributed by subscription. There are currently no subscription distribution models active in the UK, and as such subscription models are not considered within our analysis.

3.8 Article 3.1 of the UK CRAR covers the full range of services relating to the creation of credit ratings, known as credit ratings activities. For simplicity and to distinguish from data feeds as well as other analytical services, the term 'issuer services' is used to refer to regulated credit rating activities which result in a public credit rating.

Endorsement of ratings

3.9 Many investors rely on credit ratings to calculate capital requirements under the Capital Requirements Regulation (CRR) and Solvency II. The majority of ratings used

by UK investors for regulatory purposes are not issued by UK CRAs, but by overseas affiliates, and endorsed by UK CRAs.

3.10 There are 3 different types of CRA whose ratings can be used for regulatory purposes in the UK: registered CRAs, certified CRAs and endorsed CRAs.

- Registered CRAs are based in the UK and are the only CRAs who can create ratings on UK based issuers or issuances for regulatory use. There are currently 9 UK registered CRAs.

- Certified CRAs are based outside of the UK, but are based in jurisdictions determined to have an equivalent legal and supervisory framework to UK CRAR. There are currently 4 certified CRAs.

- Endorsed CRAs are overseas affiliates of registered UK CRAs determined to have an equivalent legal and supervisory framework to UK CRAR. The decision to endorse some or all the credit ratings lies exclusively with UK CRAs.

Transparency obligations on CRAs

3.11 Credit ratings can enhance market stability by reducing information asymmetries between market participants throughout the life of a debt instrument. To meet this need, CRAs update ratings to reflect perceived changes in credit risk of the issuer. CRAs communicate these changes to stakeholders transparently to avoid market volatility.

3.12 Credit ratings were not widely accessible publicly until the mid-2000s. There have since been global efforts to increase the transparency and timeliness of credit ratings disclosure. Under UK CRAR, CRAs are required to transparently communicate the following:

- **Ratings action:** Any announced change to a credit rating, including affirmation of current rating, upgrade, downgrade, or withdrawal of a rating.

- **Ratings outlook:** An opinion about the potential direction of a rating over the medium term. Outlooks are typically split into 4 categories: stable, positive, negative, and developing.

- **Credit watch:** A type of ratings outlook indicating that a CRA is currently reviewing a rating which may lead to a negative downgrade. These are often viewed by market participants as distinct from ratings outlooks.

3.13 UK CRAR additionally requires CRAs to publish the underlying methodologies for their ratings. This includes by industrial sector, asset class and in any other relevant categories.

3.14 CRAs are required to disclose all this information on a non-selective basis and in a timely manner. Ratings updates are typically published immediately on CRAs' websites and in data feeds.

3.15 CRAs are required to submit an updated list of issued and endorsed public credit ratings to the FCA's supervisory credit ratings database, RADAT, each day, which is then published on the FCA's Public Ratings Database (PRD). Similar requirements in the EU mean that ratings are provided for publication on ESMA's European Ratings Platform (ERP).

The influence of ratings on market prices

3.16   Market prices are the prices of securities being sold on secondary markets, such as stock exchanges and brokerage platforms. We investigated the impact of credit ratings on market prices. If credit rating changes are a source of significant and sudden market reaction and price movements, this directly impacts the value, and necessity, of investors accessing credit ratings through live data feeds.

3.17   Whilst ratings can be influenced by confidential information acquired from issuers, in general, market participants viewed rating changes as having limited independent influence on market prices, and this was not a driver behind firms' requirements for live data feeds. This view was supported by academic research.

3.18   The following reasons were given for why in most cases a change or updated credit rating has limited impact on market price:

- A core value of credit ratings is their contribution to market stability. CRAs are expected to signal expected ratings reviews and changes transparently, potentially weeks or months in advance, to avoid market volatility.

- Many investors have sophisticated risk teams continually assessing market information. As such, investors are rarely solely dependent on ratings to understand credit risk. Perceptions of risk are reflected in market prices independently of ratings.

- Instead, credit ratings are an independent validation of credit risk largely known to market participants, rather than an unexpected source of new information.

- Negative changes to an issuer's credit risk, and the resulting impact on their debt issuances, is typically a gradual process over months or years. This gives investors time to slowly divest from an asset.

- On occasions where ratings do significantly change in a short period, this is typically triggered by publicly known information, such as government policy changes, M&A announcements, share buybacks or profit warnings.

- Issuers and debt instruments are commonly rated by multiple CRAs, with each CRA updating ratings at different schedules. This mitigates the market impact of a rating change from 1 CRA.

3.19   There is evidence that credit rating changes can have a more significant impact on high yield bonds: bonds issued by issuers with lower credit ratings, which offer higher returns, but also a higher risk of default. This in part reflects a lower amount of quality public information on such instruments, and less research conducted by investment firms' own credit analysts.

3.20   Rating changes have a larger impact on market prices when they cause an instrument to be viewed as high yield rather than investment grade, which could make holding the instrument more costly in terms of capital requirements. Whilst a significant proportion of ratings are upgraded or downgraded each year, external research indicates less than 1% of downgraded bonds transition to a high yield rating.
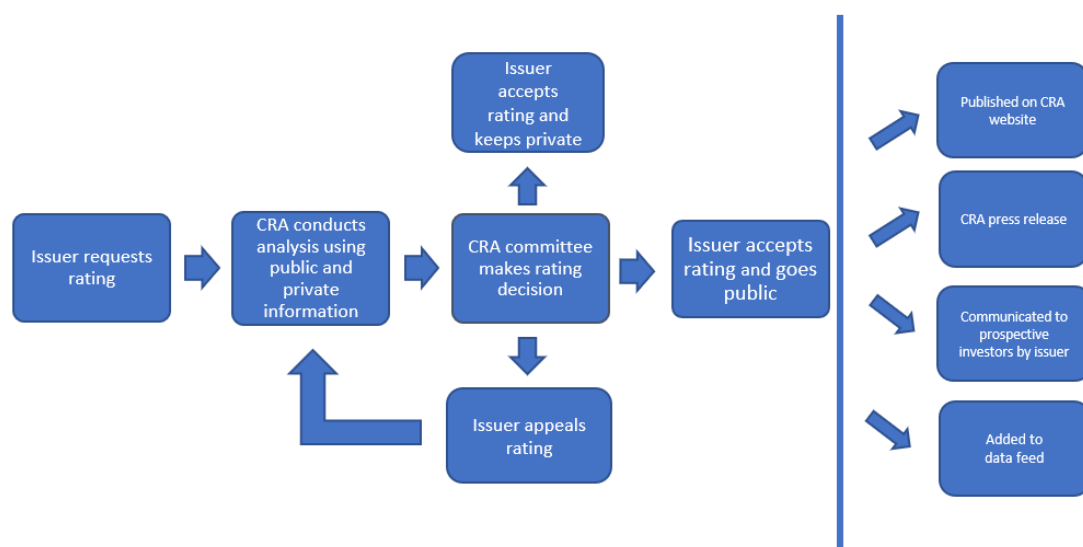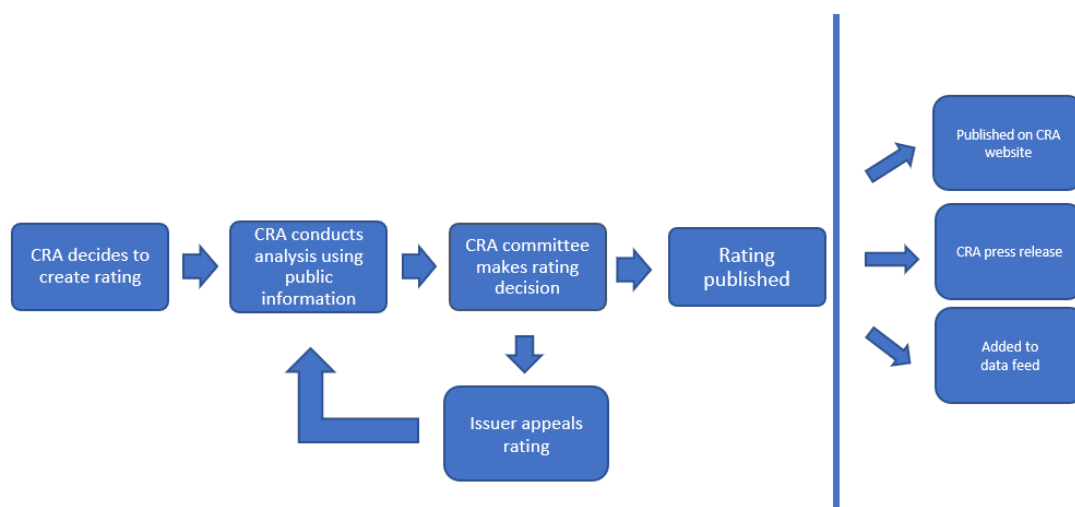
Solicited and unsolicited ratings

3.21 This section covers the differences between solicited and unsolicited ratings and the barriers to creating unsolicited ratings.

3.22 An unsolicited rating is a credit rating assigned to an issuer or debt instrument without request, payment or the receipt of supporting information from the issuer. This contrasts with solicited ratings, where issuers typically approach CRAs and pay for ratings.

3.23 Historically, unsolicited credit ratings have been used as a strategic tool by challenger CRAs to gain a foothold in the issuers services market.

3.24 The UK CRAR does not differentiate between solicited and unsolicited ratings in terms of their regulatory standards, with both types of ratings required to adhere to the same level of quality with regards to the assessment process. However, unsolicited ratings are required to be identifiable, and this is typically achieved with a lower case 'u' attached to the end of the rating category, such as 'BBBu'.

3.25 Similarly, capital requirements regulation does not distinguish between solicited and unsolicited ratings for the calculation of risk weights on assets.

3.26 As such, we were interested in the demand for unsolicited ratings from investors and the potential to enable challenger CRAs to build up sufficient coverage to compete with data feeds offered by the largest 3 CRAs.

3.27 CRAs may create unsolicited ratings as part of issuer services, such as to understand the credit risk of a counterparty, typically a bank, being used in a securitisation issuance. Unsolicited ratings can additionally serve as a strategic tool for smaller CRAs for the following reasons:

- **Showcasing analytical capabilities:** By issuing unsolicited ratings, challenger CRAs can demonstrate to the market their analytical competence and rating methodology.

- **Filling market coverage gaps:** Challenger CRAs might focus on niches or segments that are under-served by the established CRAs, such as regional markets, riskier debt, or specific asset classes.

- **Regulatory recognition:** Market coverage and an established track record can be a criterion for regulatory acceptance, such as for External Credit Assessment Institute (ECAI) status in the EU. By issuing unsolicited ratings, smaller CRAs can meet these thresholds faster.

- **Providing alternative views:** Unsolicited ratings can provide an alternative view on an issuer's creditworthiness. This alternative opinion can be helpful to market participants wary of potential rating herding or any biases that may be exhibited by the largest CRAs.

3.28 Our engagement with CRAs found that unsolicited ratings were primarily a tool to encourage interest in their issuer services, rather than to enhance their investor-targeted data feed and analytics services.

3.29 The following barriers to the creation, and maintenance of unsolicited ratings by CRAs were identified:

- **Access to information:** Solicited ratings involve significant amounts of non-public information being provided by issuers, as well as access to senior management. Unsolicited ratings instead rely on publicly available information. This can limit the depth of credit analysis. Most CRAs have policies of not creating unsolicited ratings if there is insufficient data. CRAs said they were able to rate sovereign and large corporate bonds with publicly available information easily, but it could be almost impossible for structured finance and private placement products.

- **Resource intensity:** Unsolicited ratings typically follow the same methodology as solicited ratings, and require significant analytical resources and expertise, with no significant difference in creation costs versus solicited ratings. Demonstrating the accuracy and reliability of methodologies requires ratings being maintained over 5 or more years. Additionally, as ratings are deemed to be a relative measure of credit risk, CRAs need to maintain multiple ratings within a sector, rather than on a specific issuer or asset. Particularly for smaller CRAs, this can be financially burdensome, and not an effective way to acquire new customers.

- **Reputational risks:** A CRA might attempt to gather attention by assigning an unsolicited rating that is significantly different from an instrument's existing solicited ratings. Market participants have told us that historically, unsolicited ratings which were significantly higher than solicited ratings have been viewed sceptically by the market, potentially as a signal that CRAs would willingly give out favourable solicited ratings. Similarly, a significantly lower unsolicited rating may be viewed as a disreputable tactic to pressure issuers into paying for a more accurate solicited rating. This scepticism was particularly focused on unsolicited ratings issued by challenger CRAs.

3.30 As part of our user survey, we asked issuers whether any CRA had assigned unsolicited ratings to their organisation or issuances over the past 5 years. Only a small number of issuers had been given unsolicited ratings. Few respondents felt unsolicited ratings had an impact on their firm, though a change in unsolicited ratings from a larger CRA could encourage queries from existing investors.

3.31 Some issuers suggested they discouraged CRAs from creating unsolicited ratings, as they still require resources from issuers' treasury management and investor relations departments to monitor and respond to any investor queries on them. Additionally, many issuers thought they had sufficient solicited ratings, with unsolicited ratings bringing little additional benefit. A few issuers suggested that unsolicited ratings had led to constructive discussions with CRAs.

3.32 The below 2 diagrams go into more detail about the differences in process between solicited and unsolicited ratings.

Figure 1: The process for a CRA issuing a public solicited rating

Issuer requests rating → CRA conducts analysis using public and private information → CRA committee makes rating decision → Issuer accepts rating and goes public

Issuer accepts rating and keeps private

Issuer appeals rating

- Published on CRA website
- CRA press release
- Communicated to prospective investors by issuer
- Added to data feed

Figure 2: The process for a CRA issuing an unsolicited rating

CRA decides to create rating → CRA conducts analysis using public information → CRA committee makes rating decision → Rating published

Issuer appeals rating

- Published on CRA website
- CRA press release
- Added to data feed

3.33   Multiple CRAs we engaged with had a perception that other challenger CRAs were producing significant amounts of unsolicited ratings and raised concerns that this practice could undermine the quality and integrity of the wider market. However, we found that unsolicited ratings formed only a small component of each CRA's total outstanding ratings, typically between 1-5%. Many challenger CRAs did not issue unsolicited ratings at all. Two CRAs mentioned that they historically created unsolicited ratings to gain market and regulatory acceptance, but were now reducing the number of unsolicited ratings they maintained. This was supported by analysis of UK traded debt instruments, which found that only a small proportion of ratings,

between 1% and 5%, were unsolicited on major asset classes, and these tended to be from challenger CRAs.

Issuer choice of CRA

3.34   As solicited ratings generated by issuer services are the main driver of breadth and depth of market coverage in data feeds, we investigated the factors influencing the choice of CRAs by issuers.

3.35   Our survey found that acquiring a rating from the largest 3 CRAs was seen as a priority. The was due to market credibility, leading to better credit terms and a wider range of potential investors.

3.36   Within our issuer survey, the majority (84%) of firms sourced services from multiple CRAs, with 20% of respondents using 4 or more CRAs. A challenger CRA was never used in isolation, with all respondents using at least 1 of the largest 3 CRAs.

3.37   Those using 4 or more CRAs were typically investment banks using a CRA specialising in the rating of structured products. Users also use specialist providers in sectors such as insurance.

Figure 3: Number of CRAs used across all issuances in past five years
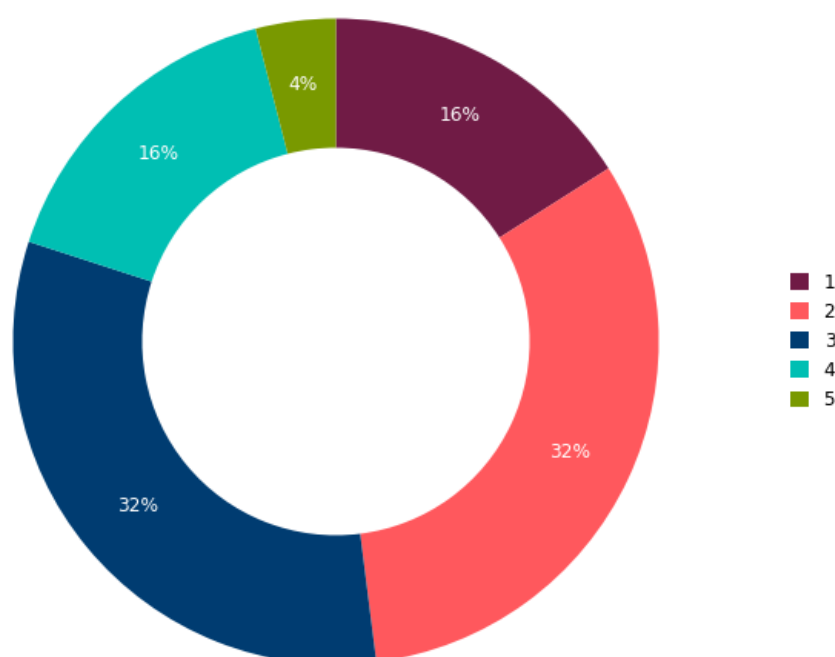
Source: FCA analysis of responses to our user survey

3.38   Our analysis of UK corporate bond markets found that, of the top 500 rated issuances, 100% had a solicited public rating from at least 1 of the 3 largest CRAs.

Less than 5% of issuances had solicited public ratings from a challenger CRA in addition to these.

Barriers to issuers using challenger CRAs

3.39 Our survey asked users if they had considered choosing a challenger CRA. 57% of respondents had, most often as a secondary rating for structured finance and securitisation issuances. Less commonly, use of a challenger was considered when there was potentially an industry-specific or geographical benefit. Despite this consideration, in practice ratings from challenger CRAs were acquired relatively infrequently.

3.40 Issuers consistently stated that the single biggest influence on CRA choice was demand from investors, with issuers' corporate treasury departments typically having pre-existing relationships with banks and other financial institutions. Investors were viewed as giving considerable preference to the largest 3 CRAs due to perception of quality and investor familiarity with rating methodology. The ratings coverage of the largest 3 CRAs is seen as enabling better peer group and international benchmarking. This in turn was seen as contributing to better asset liquidity, reducing holding and trading costs to investors. Paragraphs 5.3 – 5.5 present a more comprehensive discussion of investor preferences relating to CRAs, individual ratings and data feeds.

Reputation of domestic CRAs

3.41 Our analysis found that challenger CRAs generally had a mixed reputation amongst market participants. Many of these perceptions related to domestic CRAs focusing on specific jurisdictions, rather than those operating in the UK.

3.42 Domestic CRAs are sometimes viewed by investors as having better understanding of local market dynamics and regulations than the largest 3 CRAs. This expertise was seen as leading to more nuanced assessments of credit risk. Market participants gave examples of local CRAs being a consideration for debt issuances in Canada, China, Japan, Mexico, and the Nordics. There were no CRAs who specialised particularly in UK debt markets.

3.43 However, there was a perception from some market participants that domestic CRAs used methodologies which were not comparable with the largest 3 CRAs, with their ratings viewed as relatively higher and not comparable. A significant discrepancy between ratings of the largest 3 CRAs and domestic CRAs is supported by industry research. Whilst higher ratings might be reflective of better understanding of local markets or benchmarking against a national peer group, some market participants have told us there has historically been a view that there might be political pressure to give higher ratings to maintain or improve local business relations.

Impact of existing relationships with the largest 3 CRAs

3.44 Many challenger CRAs are relatively new to the UK market, having emerged in the past 15 years. This contrasts with the largest 3 CRAs which each have history spanning back almost a century. Issuers benefit from being rated by the same CRA

over the long term to enable historical comparisons and a consistent, continuous record of an issuers' creditworthiness. Additionally, these longstanding relationships allow for CRAs to build up familiarity with issuer's business structure and financial strategy, reducing the costs of new issuances and monitoring versus switching to a different CRA. Challenger CRAs highlighted that long-standing relationships between issuers and the largest 3 CRAs inhibited them being chosen for new issuances, or switched to, due to issuer familiarity and past satisfaction with the largest 3 CRAs.

3.45   Many regular debt issuers have relationships with the largest 3 CRAs going back decades, and we found it was rare for issuers to switch issuer services provider. In our issuer survey, 83% of issuers had a relationship with a CRA of 10 or more years, and 39% of 20 or more years. Engagement with the largest 3 CRAs reflected the findings of our issuer survey.

3.46   Additionally, issuers frequently had covenants within contracts with institutional lenders, such as commercial banks, that required them to maintain a credit rating from the largest 3 CRAs. Switching to challenger CRAs may be in breach of these contracts.

Global regulatory barriers

3.47   Issuers prefer to work with CRAs that are globally recognised to attract the widest possible investor base. Smaller CRAs flagged that differences in regulation made this challenging, with many jurisdictions having regulatory frameworks which implicitly or explicitly benefited the larger CRAs.

3.48   Two challenger CRAs mentioned that they did not meet the eligibility criteria from the European Central Bank (ECB) to be an External Credit Assessment Institute (ECAI), meaning their ratings could not be used in the Eurosystem Credit Assessment Framework (ECAF). In short, this means that their ratings cannot be used to enable debt instruments to be used as collateral when investment firms borrow money from the ECB, a significant driver of use of ratings.

3.49   Structured finance was consistently seen as the main market where challenger CRAs could compete with the largest 3 CRAs. However, 2 challenger CRAs said that not having NRSRO status in the US, broadly the equivalent of being a UK CRA, limited issuers' willingness to use them, even for UK structured finance issuances. This was due to limitations accessing US based investors. Challenger CRAs also highlighted that, whilst under UK CRAR they did not need to have UK operations, this was not the same for regulation in other jurisdictions, including Japan.

Figure 4: Proportion of sample using specific CRAs
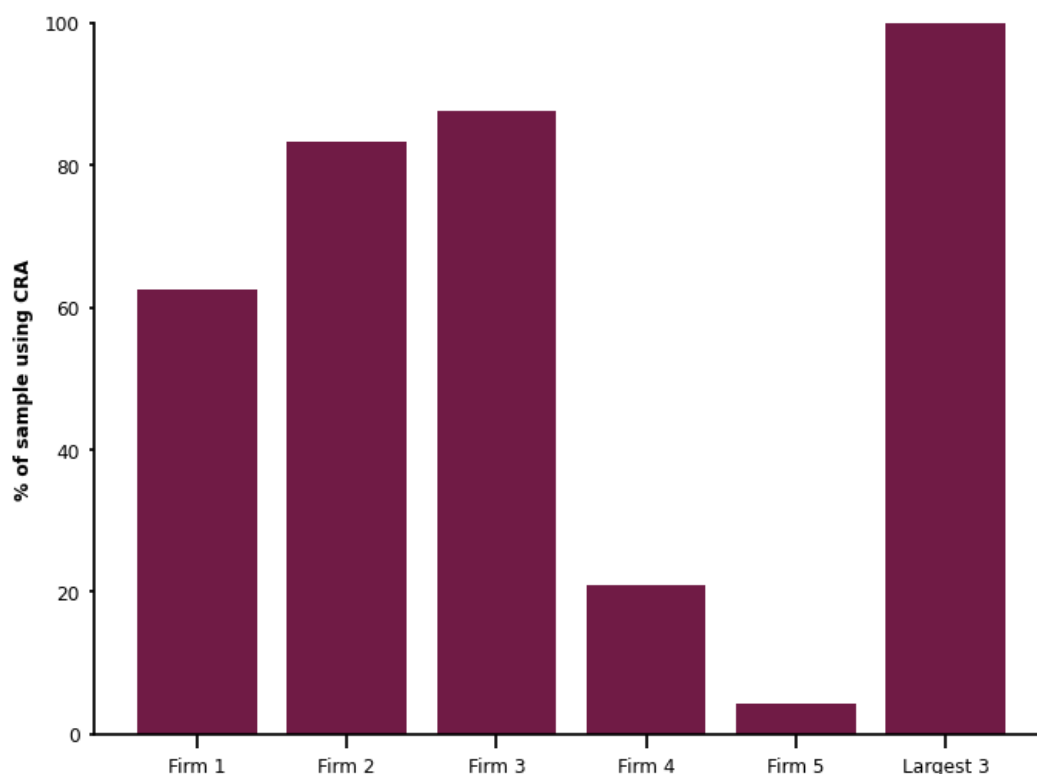
Source: FCA analysis of responses to our user survey

Role of other intermediaries in issuer choice of CRA

3.51 Many CRAs rely on intermediaries to acquire new issuer services clients. Underwriters, typically investment banks, play a significant role in the risk assessment, pricing, and marketing of new issuances. We engaged with intermediaries to understand the influence they have on issuer choice of CRA. Engagement with both issuers and underwriters confirmed that underwriters consistently played an impartial role in the exact choice of CRA, and any decision to acquire ratings from multiple CRAs. The same impartiality was found for legal firms, who play an equally crucial role in the regulatory and compliance aspects of new issuances.

Use of multiple ratings by issuers

3.52 Though it is possible for issuers to access capital markets with a single credit rating, there are strong incentives to acquire ratings from multiple CRAs. We investigated the rationale for issuers acquiring 2 or more ratings on their organisation and issuances, and any impact this had on choosing smaller CRAs. Whilst demand for multiple ratings could potentially benefit challengers CRAs, we found evidence it may instead reinforce the use of ratings from the largest 3 CRAs.

3.53 To demonstrate the prevalence of multiple ratings, we analysed the 500 largest outstanding corporate bonds issuances in the UK. We found over 90% had ratings

from at least 2 of the largest 3 CRAs, and 59% had ratings from all the largest 3 CRAs. This can be seen in Figure 5. Whilst this refers only to the UK corporate bond market, our engagement with regulators and other market participants confirmed that the prevalence of dual rating is reflective of coverage in other developed markets in North America and Europe.

Figure 5: Percentage of ratings coverage by the largest 3 CRAs for the largest 500 corporate bond issuances in the UK as of December 2023
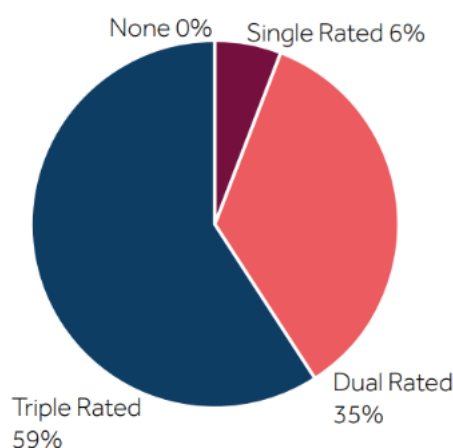
*Based on sample of the largest 500 UK corporate bond issuances. 18 issuances (3.8%) did not have public ratings available. This is due to a combination of withdrawn or private ratings. These 18 issuances did not have ratings from challenger CRAs.

3.54 Our engagement with market participants found that, though the benefits of multiple ratings might be marginal for smaller or less frequent issuers in terms of market access and borrowing terms, it was established due diligence to acquire multiple ratings.

3.55 Additionally, ratings can also influence an issuer's internal financial policies. Acquiring ratings from different CRAs, and the associated engagement with their credit analysts, captures different risk factors and insights that can help issuers to develop more sophisticated credit risk mitigation strategies. This can further influence an issuer's dividend payments, share repurchase plans and broader investment strategy.

3.56 The following interrelated reasons for acquiring multiple ratings, relating to engagement with investors and regulators, were additionally highlighted:

- **Increased credibility:** Having multiple credible ratings can enhance investor trust, especially if ratings are consistent. It also can reduce the perception that issuers having been 'ratings shopping', ie, engaging with multiple CRAs and choosing to only publish the highest ratings.

- **Diversified investor base:** Many regular issuers may start out only having ratings from 1 or 2 CRAs, then gradually acquire ratings from more niche providers to broaden appeal for investment from additional markets.

- **Regulatory requirements:** Certain asset classes, such as structured finance instruments, can be required to have multiple credit ratings from different CRAs.

- **Better terms of credit:** Issuers saw acquiring multiple ratings as necessary to secure better interest rates and narrower spreads, with this added value exceeding the additional costs of a second rating.
- **Greater market access:** Some investors or investment mandates require ratings from multiple CRAs, and as such multiple ratings can broaden the issuer's access to a wider pool of investors. As discussed in paragraph 5.22, many fixed income portfolios track fixed income benchmarks, with many leading benchmarks requiring securities to have 2 or more credit ratings for inclusion.
- **Diversification of opinion**: Different CRAs have varying methodologies, expertise, and perspectives. Multiple ratings provide a broader assessment of credit risk creditworthiness to investors and are viewed as mitigating the chance of errors made by an individual CRA.

Third ratings and downgrade risk

3.57   We engaged with industry to find out about why large corporate issuers typically had ratings from all the largest 3 CRAs. Acquiring 3 ratings was not found to be an international regulatory or investor requirement in most cases, although some fixed income benchmarks do require constituents to have 3 ratings for inclusion. Furthermore, there was limited evidence that 3 ratings lead to significantly better borrowing terms for new issuances, or increased liquidity in secondary markets. Instead, the main incentives for acquiring 3 ratings were to do with split ratings and mitigating downgrade risk.

3.58   It is common for split ratings on the same asset to differ by a single risk level, known as a notch. In these cases, it is market practice, and often regulatory guidance, to use the lower of the 2 ratings. This can be significant, when one rating is investment grade and the other rating is classified as high yield.

3.59   This split can mean higher capital costs for holding the instrument, bond selloffs and covenant triggers which can negatively impact both issuers and existing investors. This is a significant risk for many issuers and incentivises acquiring a third rating. When there are 3 or more split ratings, typically the middle or most common rating is used. As CRAs typically update ratings at different schedules, having 3 ratings both mitigates downgrade risk and gives issuers more time to adjust to an anticipated rating change. The dynamics of mitigating downgrade risk with this strategy are illustrated in Figure 6.

Figure 6: Why issuers acquire 3 ratings to mitigate downgrade risk

CRA #1 Rating	CRA #2 Rating
BBB	BB

Result: **BB**
(High Yield)

In the event of two ratings split, the market will use the lower of the two ratings to establish credit risk

CRA #1	CRA #2	CRA #3
BBB	BB	BB

Result: **BB**
(High Yield)

In the event of a three rating split, the market will use the average rating

CRA #1	CRA #2	CRA #3
BBB	BB	BBB

Result: **BBB**
(Investment grade)

As such, a third rating only ever has a neutral or beneficial impact on market consensus of credit risk

This results in corporate bond issuers commonly seeking
3 ratings to mitigate downgrade risk.

3.60 Our engagement with underwriters found that issuers followed a gradual process in acquiring ratings from different CRAs. Many issuers start out only using 1 or 2 CRAs but, as they became more experienced issuers of debt and confident in their firm's low credit risk, they increasingly seek out additional ratings.

3.61 We found limited evidence that multi-sourcing provided an opportunity for challenger CRAs to compete alongside the largest 3 CRAs, but instead it potentially contributes towards their dominance in international markets.

3.62 We understand that the resource intensive nature of maintaining ratings impacts choosing a challenger CRA even when multi-sourcing. Issuers are expected to assemble frequent information packs to provide to CRAs, including confidential financial statements, management and corporate strategy presentations and risk management policies.

3.63 Monitoring ratings requires CRAs to hold relatively frequent meetings with issuers' senior management team and liaise with investor relations. When acquiring multiple ratings issuers may not have the capacity to maintain ratings beyond those typically those from the largest 3 CRAs.

3.64 Our analysis of the UK corporate bond market found that prevalence of triple ratings was overwhelmingly a combination of ratings from all of the largest 3 agencies, who collectively accounted for more than 95% of the solicited ratings on triple rated corporate bonds.

Focus: The emergence of Fitch Ratings as a leading CRA

To assess the potential for emerging CRAs to compete with the 3 largest CRAs, it is helpful to understand how the market moved towards the current dynamic of 3 large international CRAs.

The periods from the 1970s until the 1990s is accepted as an era when both Moody's and S&P controlled the credit ratings market. At the time, Fitch Ratings was a relatively niche CRA focused on rating structured finance products in the US market. Fitch Ratings was part of a billion-dollar acquisition strategy, merging with most of the prominent challenger CRAs including IBCA, Duff & Phelps and Thomson BankWatch. This helped Fitch Ratings expand its international presence and give it critical mass to compete with Moody's and S&P, as well as differentiate itself from other challengers.

Several additional factors enabled Fitch Ratings to grow its international presence:

- Macroeconomic stability, lower inflation in European markets and a general trend away from expensive bank finance meant organisations were increasingly turning to bond issuances for financing. This in turn significantly increased demand for credit ratings from new issuers.
- The aging population in many developing countries led to increased demand for fixed-income securities which were generally considered safer for inclusion in pension funds.
- The introduction and growth of structured finance products like mortgage-backed securities (MBS) and asset-backed securities (ABS) similarly increased demand for credit ratings on a broader range of assets.
- There was increased demand from investors for more credit opinions, especially in situations when ratings on issuers of corporate bonds from Moody's and S&P were different.

Even with the above factors, the process of Fitch Ratings achieving significant coverage, and market acceptance, compared to Moody's and S&P has taken decades. Many firms we engaged with as part of this study additionally said that in certain areas of capital markets, particularly in North America, Fitch was still not treated as fully comparable, and the market remained concentrated between Moody's and S&P.

Firms consistently gave Fitch Ratings as an example for why they viewed it unlikely that there would be another challenger CRA competing with the largest 3 CRAs in the near future, with market participants expecting it to take at least 20 years before any of the existing smaller CRAs could viably compete.

Impact of Article 8d on issuer choice

3.65 One of the aims of the UK CRAR is to increase competition by encouraging the use of challenger CRAs. Article 8d of both the UK CRAR and EU CRAR places a requirement on issuers intending to appoint at least 2 CRAs for a specific issuance, to consider appointing a capable CRA with no more than 10% of total market share, and document any decision not to appoint one. To facilitate this, both the FCA and ESMA publish annual market share figures for CRAs. The most recent FCA UK market share report can be found [here](#).

3.66 We engaged with industry to find out the impact of Article 8d since its implementation in 2013. All the challenger CRAs stated that Article 8d had little or no influence on issuer choice. Challenger CRAs also highlighted it might have unintended negative effects, framing the consideration of using challenger CRAs to a short decision regarding new issuances, instead of comprehensive evaluation of the wider value of challenger CRAs. One challenger CRA reported there had been an impact where one EU regulator proactively and repeatedly reminded issuers of their requirements under Article 8d.

3.67 In our survey of issuers, 62% of respondents suggested Article 8d has had limited impact on their choice of CRA. Issuers highlighted that they can only justify challenger CRAs when there is benefit to their terms of credit, and therefore they need challenger CRAs to demonstrate that investors use their ratings. A small number of issuers identified situations where they had widened their consideration of potential CRAs with Article 8d in mind.

4 Overview of data feeds

Introduction

4.1 The focus of this chapter is on data feeds which include public credit ratings. As previously mentioned, this is distinct from:

- The issuer-pays subscription model, where investors pay for the creation and access of non-public ratings.
- The distribution of private ratings created for specific lending or investment decisions, which are distributed to a small number of investors at the discretion of issuers.

4.2 There are a variety of channels for accessing credit ratings. Paid-for data feeds are only purchased by a minority of market participants.

4.3 This section relates to investors who make such extensive use of credit ratings, free databases, and commercial data feeds. This is typically the very largest banks, insurers, and asset managers.

4.4 We understand that investors regularly purchase complementary services from CRAs including risk modelling tools, sector research and direct access to credit analysts. These services are out of scope of our demand analysis, though their impact on choice of data feed supplier is considered.

Use of individual credit ratings by investors

4.5 Investors use individual credit ratings when a financial transaction involves a specific rated issuer or asset, including:

- Pricing and purchasing new issuances in the primary debt market.
- Assessing a particular bond issuance in the secondary debt market.
- Lending to another financial institution in the interbank lending market.
- Assessing the credit quality of collateral provided in a lending agreement.
- Assessing the credit quality of firms as part of M&A strategy.
- Evaluating a counterparty being used in a loan agreement.

4.6 Credit ratings are infrequently used in traditional lending, such as commercial banks' lending to non-financial corporates, where instead lenders conduct internal risk assessments, though the process may be similar to that of CRA assessments.

4.7 Investors might use multiple ratings, covering a range of different assets, in stakeholder communications. This includes client-focused presentations, factsheets, or online content, to promote their investment strategy or demonstrate the quality of existing assets in their investment portfolios.

Access channels for individual credit ratings

4.8 Aside from data feeds and regulatory databases discussed in this chapter, investors have many different free channels to access individual ratings. This includes:

- CRA websites
- Email alert services
- Press releases
- Financial news
- Fixed income trading platforms

- Issuer websites
- Issuers' investor relations teams
- Underwriters
- Brokerage firms
- Bond prospectuses

4.9 Figure 7 covers the main channels used for accessing multiple credit ratings.

Figure 7: Main distribution channels of credit ratings data
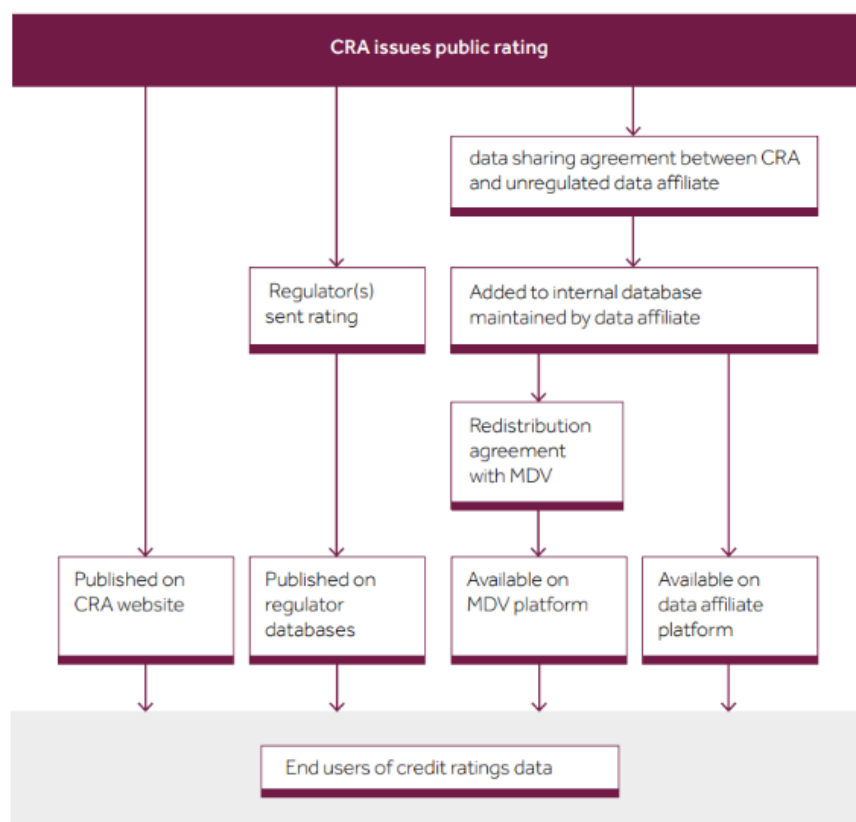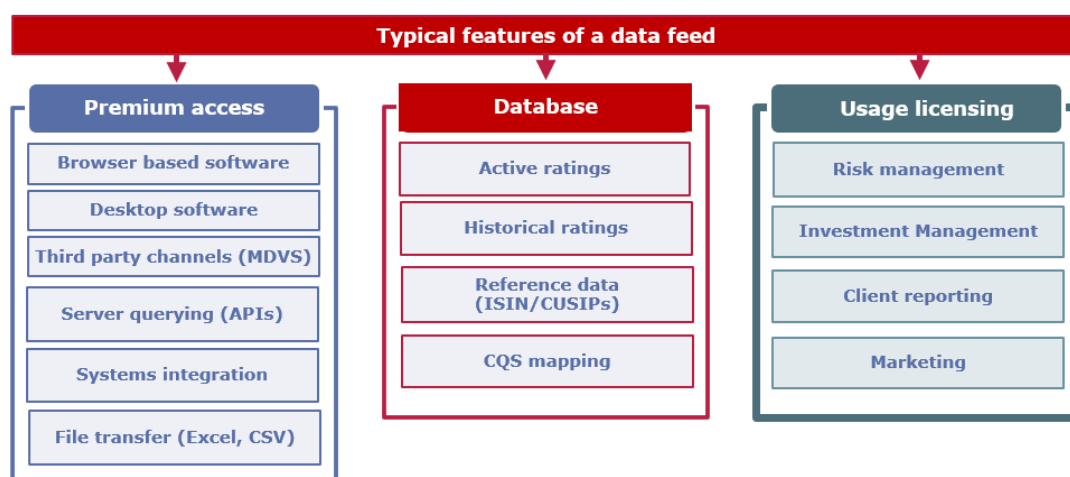

Use of supplementary information from CRAs

4.10 Particularly for individual investment decisions, credit ratings are only one aspect of investors' credit risk assessments. Nearly all users in our survey suggested they also made use of supplementary qualitative reports created by CRAs. This includes rating commentary, macroeconomic research, country risk assessments, industry and

sector analysis, and thematic papers. A number of respondents suggested that these qualitative reports are often considered more important than the ratings themselves.

Demand for data feeds

4.11 The growing quantitative capacity of investors, driven by advancements in data analytics and financial modelling, as well as market expectations of more thorough risk assessments, has significantly increased demand for credit ratings. These investors have integrated sophisticated risk assessment and portfolio optimisation techniques into their investment processes.

4.12 A database of credit ratings, such as those included within data feeds, is needed to understand the relative risks within a sector, comparing assets, or identify trends. This includes assessing and managing the concentration risk and ensuring their exposure is well-diversified across different entities and credit risk profiles.

Figure 8: Typical features of a data feed

Typical features of a data feed

Premium access	Database	Usage licensing
Browser based software	Active ratings	Risk management
Desktop software	Historical ratings	Investment Management
Third party channels (MDVS)	Reference data (ISIN/CUSIPs)	Client reporting
Server querying (APIs)	CQS mapping	Marketing
Systems integration		
File transfer (Excel, CSV)		

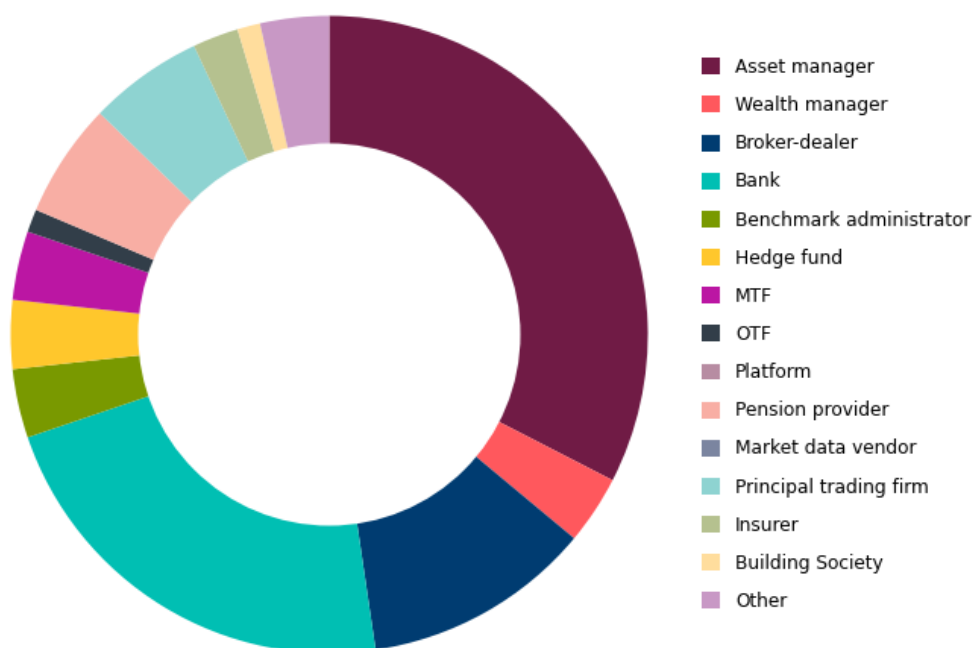## The rationale for using data feeds rather than free sources

4.13 Investors' decisions to source credit ratings from commercial data feeds depend on several factors, including the breadth and depth of their fixed income activities, the sophistication of their investment strategies and risk management processes, regulatory requirements, and the need for real-time data.

4.14 For large commercial operations, data feeds can enable institutional investors to efficiently incorporate credit ratings on thousands of instruments into their operations. Users had the following motivations for paying for data feeds:

- **Market coverage:** Free sources offer limited market coverage, focusing on only 1rating or a small subset of ratings. Data feeds provide a comprehensive view of ratings across whole sectors and regions.

- **Historical data:** Access to historical ratings changes and trends over time can help investors analyse an issuer's creditworthiness evolution and modelling different scenarios for stress testing.
- **Systems integration:** data feeds typically offer options for customisation and workflow integration into investors' internal systems and models.
- **Real-time updates:** Data feeds often provide real-time or near-real-time updates or on rating changes, which can be critical for making timely investment decisions. Some free sources might be static or have delays in updating rating changes.
- **Usage licensing:** Individual credit ratings are proprietary information and are considered intellectual property. Using them without permission could have legal implications for firms. Data feeds typically include licensing agreements which covers commercial usage.
- **Liability:** Licensing agreements included within data feeds can also ensure that use comes from a service that meets legal and regulatory standards, minimising liability risks of incorrect credit ratings being used in operations. Using reliable data sources can be a regulatory requirement. Data feeds provide the assurance of accuracy and reliability that comes with contractual agreements.

Users

4.15 A wide variety of financial organisations use data feeds. Our analysis of customer-level transaction data found that most users were either banks or asset managers, with the next largest user group being insurers. This analysis also highlighted a significant number of non-financial users of data feeds, including consultancies, academic institutions, technology firms and commodities traders.

4.16 These findings are reflected within our user survey of which around 55% of users were asset managers or banks. Other financial firms in our user sample included insurers, broker-dealers and pension providers. The split of different user types in our data is set out in Figure 9.
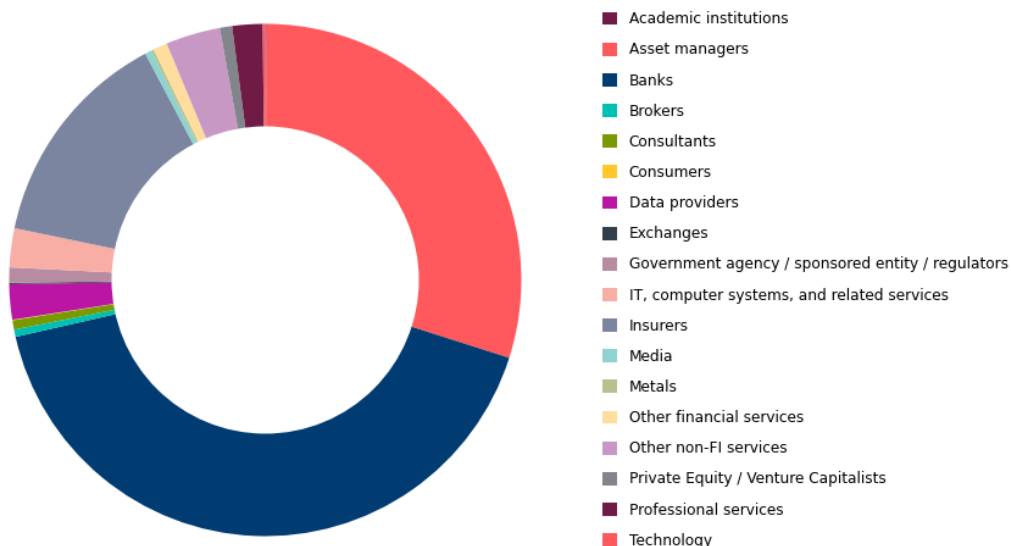
Figure 9: Credit rating data user types

- Asset manager
- Wealth manager
- Broker-dealer
- Bank
- Benchmark administrator
- Hedge fund
- MTF
- OTF
- Platform
- Pension provider
- Market data vendor
- Principal trading firm
- Insurer
- Building Society
- Other

Source: FCA analysis of responses to our user survey

4.19   Insurers are one of the most significant users of data feeds but were underrepresented in our user survey. We held an additional discussion with the Association of British Insurers (ABI) to ensure the views of insurers were considered within our analysis.

Figure 10: Proportion of revenue driven by client types for the largest 3 CRAs

Legend:
- Academic institutions
- Asset managers
- Banks
- Brokers
- Consultants
- Consumers
- Data providers
- Exchanges
- Government agency / sponsored entity / regulators
- IT, computer systems, and related services
- Insurers
- Media
- Metals
- Other financial services
- Other non-FI services
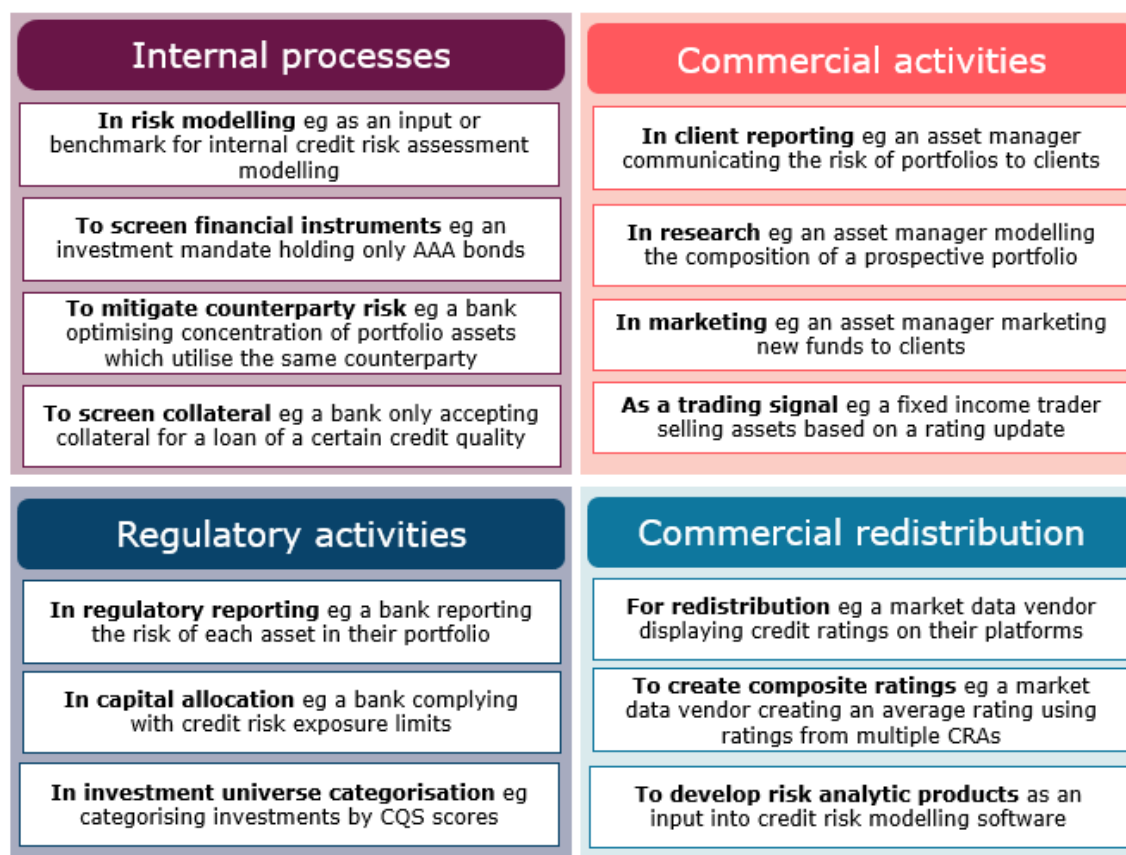- Private Equity / Venture Capitalists
- Professional services
- Technology

Source: FCA analysis of CRA transaction level data.

4.22 Figure 10 shows the split of the market by revenue from our transaction level data. The types of clients given in this data were those provided by firms, and so do not necessarily match the list for the user count.

Use cases of data feeds

4.23 Data feeds are used for a wide variety of reasons. Figure 11 sets out our assessment of the main use cases.

Figure 11: Main uses of data feeds

Internal processes	Commercial activities
In risk modelling eg as an input or benchmark for internal credit risk assessment modelling	**In client reporting** eg an asset manager communicating the risk of portfolios to clients
To screen financial instruments eg an investment mandate holding only AAA bonds	**In research** eg an asset manager modelling the composition of a prospective portfolio
To mitigate counterparty risk eg a bank optimising concentration of portfolio assets which utilise the same counterparty	**In marketing** eg an asset manager marketing new funds to clients
To screen collateral eg a bank only accepting collateral for a loan of a certain credit quality	**As a trading signal** eg a fixed income trader selling assets based on a rating update

Regulatory activities	Commercial redistribution
In regulatory reporting eg a bank reporting the risk of each asset in their portfolio	**For redistribution** eg a market data vendor displaying credit ratings on their platforms
In capital allocation eg a bank complying with credit risk exposure limits	**To create composite ratings** eg a market data vendor creating an average rating using ratings from multiple CRAs
In investment universe categorisation eg categorising investments by CQS scores	**To develop risk analytic products** as an input into credit risk modelling software

4.24 The following explores some of these uses in more detail. It is important to note that many smaller firms, and those with less fixed income holdings, may not need to purchase data feeds to meet their needs.

Risk modelling

4.25 Many investors implement sophisticated approaches to risk management, employing dedicated analysts and using advanced computer modelling. This includes using ratings to model credit risk exposure at the portfolio level, or to model exposure across the whole investment firm. The role of credit ratings within these models varies, they can be a key input or simply used as an external validation and benchmarking tool.

Screening financial instruments

4.26 Investment guidelines often use ratings to define the pool of potential investments that can be purchased so a portfolio maintains a certain level of risk. It is common for fixed income funds to require potential investments to have a minimum credit rating, such an AAA rating from 1or more CRAs. This can be driven by the guidelines imposed by institutional clients, and in some cases local regulation require investment universes to be limited to rated instruments.

Investment universe and categorisation

4.27 Investors typically want to maximise returns for a given level of risk, whilst mitigating the amount of regulatory capital that must be held in reserve. There may also be more granular constraints on exposures, such as no more than 20% of the portfolio's being invested in assets rated BB (high yield) or below. This means it is very common to initially categorise investments using ratings, and fixed income research teams may be organised similarly, with different teams for different ratings categories. Using ratings as a primary basis for categorisation can additionally aid with regulatory monitoring and reporting requirements.

Client reporting and marketing

4.28 Even where investors depend on their own internal credit assessments, credit ratings are commonly used to translate a firm's internal evaluation of credit risk to institutional clients. This includes activities such as regular reporting to clients and advertising the risk strategy of newly launched investment funds.

As a trading signal

4.29 Passive investment portfolios often replicate fixed income benchmarks as part of their investment strategy. As underlying constituents of a benchmark 'enter' or 'leave', investors will adjust their portfolios accordingly by buying or selling the relevant bond.

Redistribution

4.30 Firms, such as MDVs, redistribute ratings data to their own customers. This use case differs from others in that it offers an alternative way for investors to access credit ratings. The factors that drive demand for redistribution are derived from the other 3 usage categories above. This is discussed further in paragraphs 4.41 – 4.44.

Regulatory activities

4.31 This section provides an overview of the regulatory use of credit ratings in capital calculations.

4.32 In the UK hundreds of firms are required to comply with UK Capital Requirements Regulation (CRR) or Solvency II regulations (SII), and these regulations were consistently seen as the most significant driver of demand for data feeds. Over 80% of respondents in our survey indicated that credit ratings are crucial for regulatory purposes.

4.33 Under these regulations, firms must assess the credit risk of assets they are exposed to, to determine the level of capital they must hold for potential losses. There are 2 main approaches to calculating risk weights:

- **Standardised Approach (SA):** This approach assigns risk weights to exposures based on ratings provided by CRAs.
- **Internal Ratings-Based (IRB) Approaches:** These approaches allow firms to use internal risk models to determine the risk weight of assets.

4.34   Holding capital has opportunity costs for financial institutions, as the capital could otherwise be invested or lent to earn a return. As such, firms are incentivised to optimise their asset allocation to minimise amount of capital they need to hold. Whilst firms may be able to better optimise their capital requirements under IRB approaches, firms overwhelmingly use the SA due to several factors, including lower operational costs and simplicity.

4.35   IRB approaches need regulatory approval with firms required to demonstrate their risk management systems and internal models meet regulatory standards. IRB approaches are typically only used by the very largest UK financial institutions. The potential for IRB approaches, and broader internal assessments, to be an effective substitute for credit ratings is discussed further in paragraphs 5.38 – 5.43.

4.36   Under the SA, Credit quality steps (CQS) are used to categorise exposure to different levels of credit risk. Credit ratings are mapped by regulators to CQS categories. There are currently 6CQS categories, with CQS 1 representing the lowest level of risk, and CQS 6 the highest.

4.37   Each CQS is associated with a specific risk weight. For example, CQS 1 assets might have a risk weight of 20%, meaning that for every 100 units of exposure, a firm must hold capital equivalent to 20 units to cover potential losses. CQS 5 assets might have a risk weight of 150%, meaning for every 100 units of exposure, a firm must hold 150 units of capital.

Figure 12: Mapping credit ratings to credit quality steps
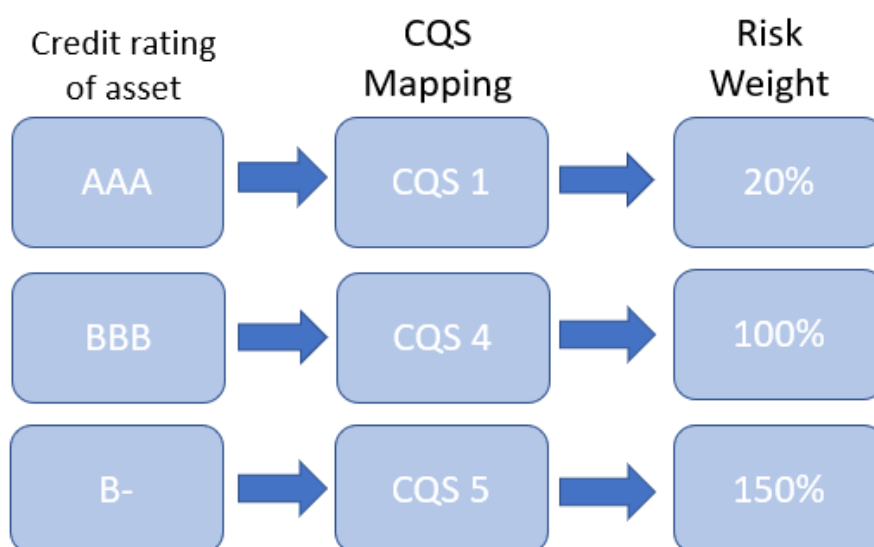
4.38   As is discussed elsewhere in this annex, it is common for assets to be rated by multiple CRAs, and for ratings to vary slightly in perceived credit risk. When ratings for the same asset map to different CQS categories, the general guidelines across CRR and Solvency II are as follows:

- If there are 2 ratings with different associated risk weights, firms should use the rating that corresponds to the higher CQS.

- If there are 3 or more than ratings with different CQS, firms should use the most common CQS.
- If there are 3 or more ratings and no common CQS, firms should use the second lowest CQS.

4.39 Although the ratings of only one CRA can be used for CQS mapping, this must be consistent across all asset exposures. The ratings of different CRAs cannot be used selectively by investors to try and minimise capital reserve requirements. As CRAs do not have comprehensive market coverage, using only 1CRA can result in some assets being classed as unrated, and investors may have to hold significantly higher capital for those assets. As such, it is common for investors to use ratings from multiple CRAs to minimise capital requirement costs.

4.40 These regulatory requirements drive demand for data feeds in the following ways:

- Firms are required to continually calculate credit risk for assets on their balance sheet and the associated level of capital reserves. Integration of data feeds ensures that investors can dynamically manage their portfolios to remain compliant and avoid potential penalties for non-compliance.
- Firms must disclose their risk exposures and capital adequacy to regulators and in publications on a regular basis. Data feeds can facilitate accurate and timely reporting.
- Data feeds typically include both credit ratings of individual assets and their associated CQS mapping. Free sources do not typically include CQS mapping.
- Even for investors using the IRB approach, credit ratings can complement internal assessments of credit risk by acting as an external benchmark. This can help in calibrating internal models, especially for validating the estimates of probability of default (PD), loss given default (LGD), and exposure at default (EAD).
- Due to the direct impact on capital costs, categorisation of investments by credit rating is often a core component of investment strategy, even if not an explicit regulatory requirement. The ambiguity between whether this is a commercial or regulatory requirement is a potential driver of using data feeds over free information sources and is discussed in more detail in paragraph 5.62.

Availability of credit ratings on MDV platforms

4.41 Users typically have the option of accessing data feeds via software included as part of the service, or via third-party software such as MDV platforms. Many users prefer to access data feeds via an MDV due to convenience and familiarity. Of those users that purchase data feeds, our analysis of suppliers found that over 70% of their users consume data feeds through MDVs.

4.42 Smaller investment firms and those with limited exposure to debt instruments are commonly able to meet the requirement for credit ratings utilising data available on the platforms of MDVs available without purchasing a data feed from a CRA data affiliate.

4.43 The reasons that users gave us for purchasing data feeds from a CRA or their data affiliate when primarily accessing ratings from an MDV included:

- Some MDVs have processes limiting the volume of data available to users who do not have an existing data feed with a CRA's data affiliate. This will typically impact users who are extensively accessing ratings data.

- Extensive commercial or operational purposes is not covered by the MDVs' licensing agreement with the CRA, and the user is aware that it is a breach of contract.

- Users prefer to have an explicit agreement with CRAs to provide contractual reassurance about data quality and any potential errors.

4.44   All of the largest 3 CRAs' data affiliates also allow for the ratings of the other CRAs to be accessed via their software, which often requires purchasing a data feed from that CRA. However, we understand this is a relatively uncommon way for users to access data feeds compared to MDVs.

The two-sided nature of the credit ratings market

4.45   Credit ratings play a valuable role for both investors and issuers in capital markets. Figure 13 demonstrates the increasing value that comes to both investors and issuers of wider market coverage from CRAs. Each side of the market benefits from increased use on the other side of the market, commonly known as an indirect network effect.

4.46   This raises a question about how each side of the market interacts and how this affects competition in the sale of data feeds. While there evidence of indirect network effects between the investors and issuers more generally, for the data feed market specifically this evidence is limited as:

- Data feeds are not a prerequisite to investors being able to access or use ratings. Both ratings and supplementary information are available and commonly accessed from a range of public, private and commercial sources.

- Greater utilisation of data feeds by investment firms does not increase the value of acquiring a specific CRA's rating to issuers. The greater acceptability of a CRA and their methodologies for investment decisions is the driver of value.

4.47   Data feeds and other analytical services are only possible due to the breadth and depth of information acquired and generated by extensive international coverage of markets. This gives the largest CRAs the advantage of being able to generate additional revenue streams that may not be possible for smaller CRAs.

4.48   In part to manage potential conflicts of interest, the largest 3 CRAs tend to supply data feeds through separate corporate entities to that of issuer services, which specialise in providing data and analytics services to investment firms. These different entities had wholly separate sales teams. The pricing of issuer services and data feeds was also managed seperately, and we found no evidence that the prices of issuer services were affected or strategically subsidised by data feeds.

4.49   Similarly, as issuer services were typically bought by issuers, and data feeds by investment firms, we found no evidence of these services being sold as part of a single package, nor discounts being negotiated on one service due to a customer purchasing the other.

**Figure 13: The cycle of increased ratings coverage**

5 Competition Dynamics and Drivers of Market Power

5.1 This chapter analyses the competition dynamics we observe in the credit ratings data feeds market to understand how they drive the outcomes we observe and explore in Chapter 6. Where relevant, we refer to other technical annexes and draw on discussion from Chapter 3 about competition dynamics in the issuer services market.

How users choose between data feed providers

5.2 Assessing drivers of choice is important to inform how easily users can feasibly switch to alternative services. We asked users the most important criteria they considered when choosing a data feed provider. The results of this analysis can be seen in Figure 14.

Figure 14: Criteria considered when choosing data feed providers
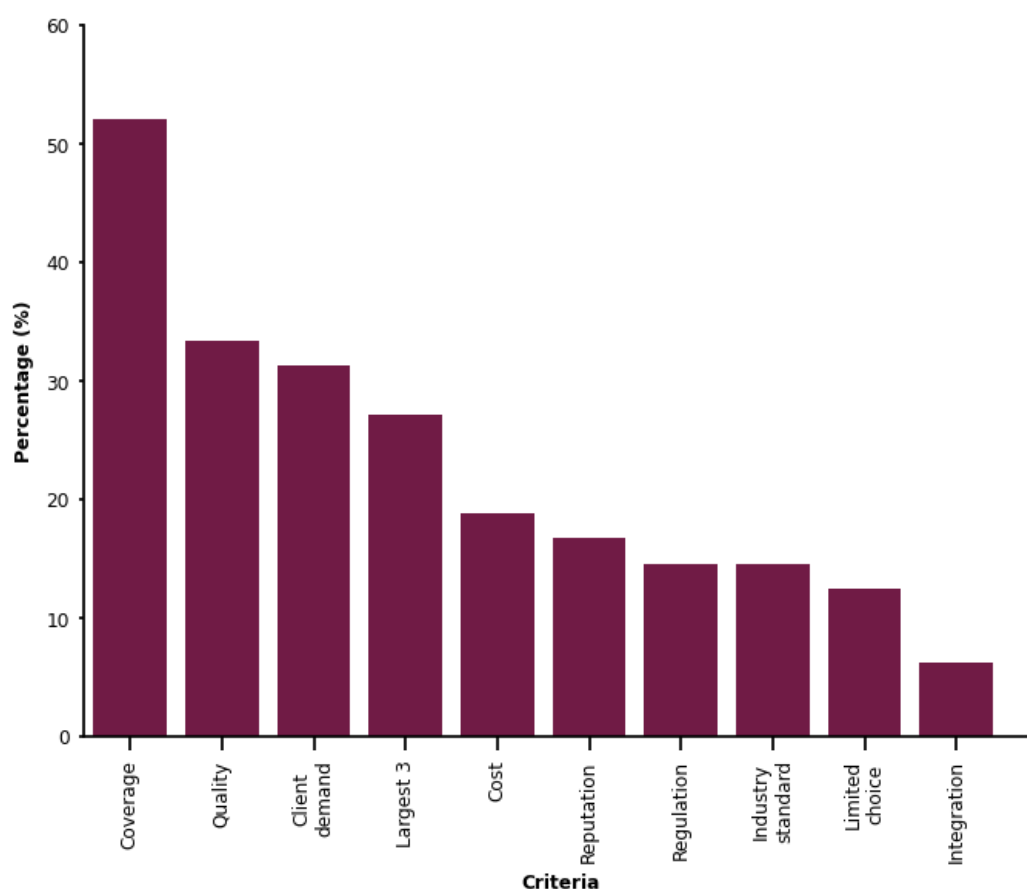
Source: FCA analysis of responses to our user survey

5.3 Our user survey found investor preferences for data feed providers is significantly influenced by perception of CRAs and their ratings methodologies as applied in issuer services. Therefore, responses not only reflect the perceived quality of data feeds, but also the quality of issuer services.

5.4 Wide coverage of debt instruments, asset classes, industrial sectors, and geographies were identified by over 50% of respondents as key drivers of choice. This includes a requirement for international coverage of corporate bond markets, as well as niche coverage of asset or country-specific submarkets. Multiple respondents suggested they require data feeds from at least 2of the largest 3 CRAs' data affiliates to achieve acceptable ratings coverage.

5.5 Over 80% of respondents explicitly state their end-client demands influence their choice of data feed provider. Typically, these firms use credit ratings to manage end-client funds and therefore, are responsive to demands for specific CRAs. End-clients expect the use of reputable, high-quality providers and will challenge the investors managing their funds if they do not use 'industry standard' credit ratings, typically seen as those from the largest 3 CRAs. Therefore, client expectations play a strong role in choice of CRAs. However, even for investors who were only managing their own internal funds, rather on behalf of extern clients there was a similar preference for the largest 3 CRAs.

5.6 Users also stated that data feed prices, access channels, and the cost of integrating data feeds into internal systems are important considerations. Finally, users stated regulation was the major driver of the requirement to purchase data feeds.

5.7 Both the largest 3 CRAs and challenger CRAs agreed with the considerations raised by users, seeing breadth and depth of coverage as the key competitive parameter in choice of data feed. Reputation is also important due to providers' assessment that brand recognition is an important competition parameter.

5.8 In summary, wide coverage is the key driver of choice for data feeds. For investment firms managing client mandates, choice is usually driven by the need to meet the coverage requirements dictated in their active mandates, alongside client demand for the industry standard providers. Other considerations include reputation, quality, price, and the delivery mechanism of data.

Demand-side substitutability

5.9 Demand-side substitutability refers to how easily users can switch between different services to meet their needs. If a user can easily switch, incumbent firms are less able to set prices above the competitive level due to the threat of losing customers to cheaper competitor services.

5.10 In our analysis we consider why firms may not be able to substitute between data feeds, as well as what services could act as suitable alternatives. These alternatives include:
- Credit ratings data available with MDV platforms.
- Free public sources of credit ratings.
- Alternative measures of credit risk.

5.11   This analysis informs our findings on whether users can feasibly switch away from data feeds, and ultimately, how this influences switching behaviour and contribute to the high concentration observed in this market.

Multi-sourcing of data feeds

5.12   We looked to establish whether there is evidence that suppliers of data feeds are engaged in rivalrous behaviour to the benefit of users. In a market that is competitive, we would expect to see users switching to better value services, with the threat of losing customers encouraging suppliers to employ competitive pricing to retain customers and win new ones. We found limited evidence of these dynamics in the UK data feed market.

5.13   Users did not typically switch between providers of data feeds, as they viewed the ratings from different CRAs as providing complementary value exceeding their combined costs, and as such were incentivised to multi-source, rather than switch between providers. Instead, the majority of users stated they licensed data feeds covering the ratings of multiple CRAs.

5.14   Our demand side survey indicated that the vast majority of firms purchased data feeds from multiple CRA data affiliates. Due to the international nature of the data affiliates combined with the international presence of many customers, UK-based users have the option to purchase data feeds from suppliers based in the U.S. or the EU. One industry association confirmed that all their members who used credit ratings licensed data feeds from U.S. based data affiliates rather than affiliates based the UK.

5.15   We asked users to highlight the factors that require them to multi-source data feeds. More than half of users cited coverage as a key reason to multi-source, with many explicitly mentioning sourcing from the largest 3 CRAs.

Figure 15: Multi-sourcing criteria
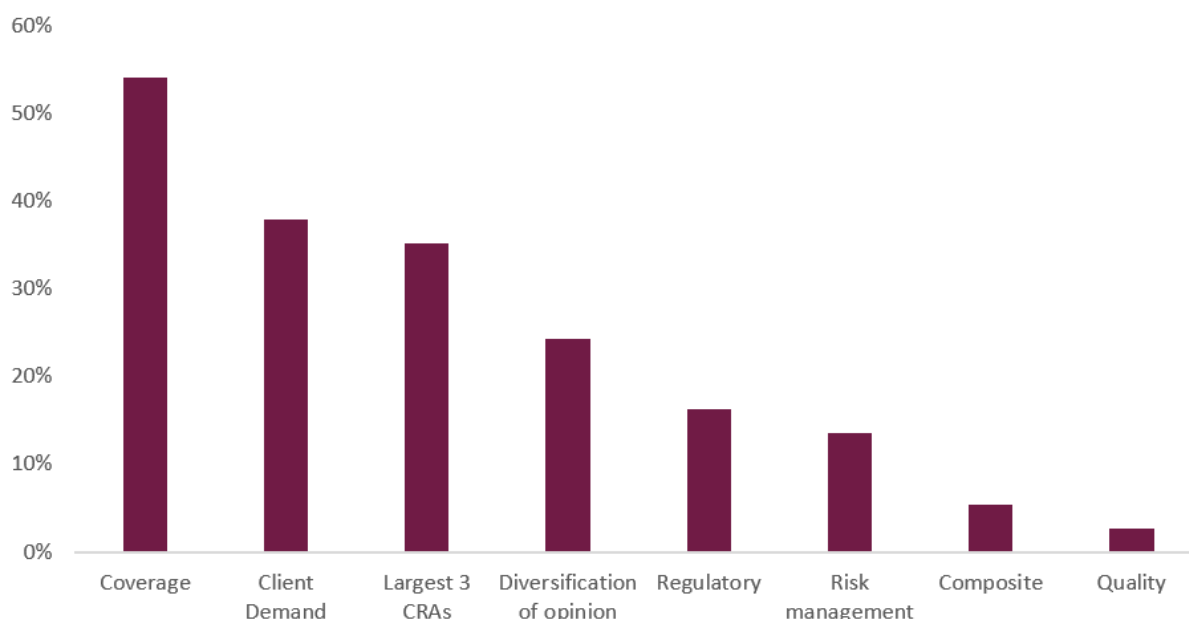
Source: FCA analysis of responses to our user survey

5.16 The practice of issuers multi-sourcing ratings has an impact on demand for data feeds. To comprehensively analyse the credit risk of an asset, an investor would need to ensure they have access to not just a relevant credit rating that had been issued, but relevant credit ratings on securities in the same asset category. Investors requiring full coverage of dual rated securities would therefore need to purchase data feeds from more than one CRA. This can be seen in Figure 16, which shows the coverage investors would get when they use ratings from multiple CRAs, based on our sample of the largest bond issuances in the UK.

Figure 16: Market coverage of the UK corporate bond market using different combinations of the largest 3 CRAs

	CRA 1 data	CRA 2 data	CRA 3 data	Coverage of dual rated bonds
Combination 1	✓	✓	✗	81%
Combination 2	✓	✗	✓	67%
Combination 3	✗	✓	✓	78%
Combination 4	✓	✓	✓	100%

*Based on the sample of 455 of the largest 500 corporate bond issuances in the UK which had ratings from at least 2of the largest 3 CRAs ('dual rated'). Of this sample, 286 bonds issuances (62.8%) had ratings from all 3of the largest 3 CRAs.

5.17   For other rated asset classes, similar arguments and evidence applies. For example, institutional investors regularly prefer, or require, instruments to be rated by 2CRAs, both in primary and secondary markets, which would create similar demand features.

5.18   This feature of demand therefore limits the extent to which users can substitute between suppliers of data feeds, and shop around to get a better deal.

5.19   There is more use of smaller CRAs in particular sub-markets, where it is more common for issuers to acquire ratings from a mixture of 1of the largest 3 CRAs and a smaller CRA. Examples include the sub-markets for BBB bonds, high yield bonds, insurance companies, and mortgage-backed securities (MBS). Users value the distinct analytical perspectives and niche expertise offered by challenger CRAs in these sub-markets. As this is usually in combination with a rating from a larger CRA, this does not reduce data requirements for specialist investors. Instead, it means such investors additionally acquire data covering both the largest CRAs and challenger CRAs.

Client Requirements

5.20   End-clients who investors manage portfolios on behalf of are a significant driver of demand for data feeds. Fund managers research credit risk across a wide universe of potential investments on behalf of clients. As such, multi-sourcing is necessary to meet the coverage requirements needed to advise end-clients.

5.21   End-clients value the diversity in opinion of using data from multiple CRAs and often consider the largest 3 CRAs to be the industry standard. Therefore, multi-sourcing may also be a mandated by clients in contracts or required for periodic reporting on the credit risk associated with their investment portfolio.

5.22   Passive investment portfolios often track fixed income benchmarks as part of their investment strategy. Benchmark methodologies often use credit ratings to determine whether a bond is eligible for inclusion in a fixed income benchmark. Many of the largest benchmark providers specify that constituents need to have at least 2ratings from the largest 3 CRAs. Less frequently benchmarks can require constituents to have ratings from all of the largest 3 CRAs.

5.23   Benchmark providers may communicate upcoming changes to the constituents of a benchmark because of a rating change. However, investors often employ controls to monitor changes in credit ratings, which can require investors to purchase data feeds.

Other requirements to multi-source

5.24   Multi-sourcing is also required for alternative use cases, such as:
- Developing composite ratings, which may be required to accurately determine the appropriate CQS risk weight, requires sourcing multiple ratings to establish a single representation of a firm's credit risk. Firms must consume data from multiple CRAs to do this.
- Meeting prudential requirements, such as those outlined in paragraphs 4.31 – 4.40. Given firms are required to assess the credit risk their investments are exposed to, often firms need to multi-source ratings.

- Diversification of opinion exists between CRAs, therefore, users multi-source to benchmark the creditworthiness of an instrument.

Summary

5.25   In summary, investors often need to multi-source data feeds covering the ratings of different CRAs. Predominantly, this is driven by coverage requirements of users and reinforced by client demand. Other requirements to multi-source include adhering to the industry norm, developing composite ratings, meeting regulatory requirements, and benchmarking credit ratings of alternative CRAs in risk modelling.

Market data vendors as competitors

5.26   This section analyses whether the ability for users to access credit ratings via MDVs, rather than directly from CRAs or their data affiliates, creates a competitive constraint on CRAs.

5.27   Some CRA data affiliates stated they directly compete with MDVs in the data feeds market. If CRAs are competing with MDVs, it could potentially improve customer outcomes by incentivising CRA data affiliates to compete more vigorously to retain customers.

5.28   MDVs do not generate their own ratings, but rather offer an alternative way to access the ratings of the largest CRAs. This is a significant means of accessing CRA data. Our survey showed that over 70% of users access CRA data feeds via MDVs. However, for MDVs to provide a competitive constraint on CRAs, we would have to observe that those MDVs have the commercial freedom to determine their pricing levels and structure independently from the CRAs and data affiliates from whom they obtain licences to redistribute the data.

5.29   Redistribution licensing arrangements are particularly relevant, and do not offer MDVs the commercial freedom that would be necessary for us to view MDVs as independent and distinct suppliers of data feeds. Whilst users can access a limited amount of ratings on MDV platforms, the redistribution agreement between MDVs and data affiliates determine the volume (and other) thresholds above which an end user must additionally license with a CRA or data affiliate directly, rather than with the MDV.

5.30   Our analysis found that most firms consume data feeds through an MDV while also maintaining a direct licence with 1or more of the largest 3 CRA data affiliates. Therefore, MDVs provide users with additional options for accessing the data feeds but are not a source of independent competitive pressure on the CRA data affiliates.

5.31   However, data affiliates of CRAs offer a multitude of other services in addition to data feeds, and in some instances are also effectively MDVs. As such, direct competition may occur between MDVs and CRAs in the provision other services including:

- Market trends and sector analysis.
- Economic forecasting.
- ESG scores and analysis.
- Portfolio analysis.

- Credit risk modelling software.

5.32 Analytics services are designed to enhance clients' risk assessments and complement credit ratings produced by CRAs, rather than replacing them. Therefore, while MDVs and CRAs may compete to provide some services that aid with credit risk analysis, these are not a direct substitute for external credit ratings.

Alternative measures of creditworthiness

5.33 Since the 2008 global financial crisis, there has been a global regulatory push for market participants to take a more diversified approach to credit risk analysis, in part to reduce reliance on credit ratings. This is also outlined in UK CRAR:

- **Article 5a** states that investors should make their own credit risk assessments and not solely or mechanistically rely on credit ratings for assessing the creditworthiness of an issuer or issuance. Additionally, UK regulators are also required to monitor firms' credit risk assessment, assess the use of contractual references to credit ratings and, where appropriate, encourage firms to mitigate the impact of such references, with a view to reducing sole and mechanistic reliance on credit ratings.

- **Article 5c** additionally requires the UK Treasury (HMT) to continue to review whether references to credit ratings in UK law trigger or have the potential to trigger sole or mechanistic reliance on credit ratings by the FCA and market participants.

5.34 Similar articles are found within EU CRAR. In the US, the 2010 Dodd-Frank act required the SEC to remove any references to credit ratings from its regulations.

5.35 In the Update Report, we committed to evaluating the impact of these regulatory initiatives on the relevance and demand for credit ratings, and the subsequent impact on data feeds. If investors are moving away from credit ratings in favour of alternative measures of creditworthiness, this could enable viable alternatives to data feeds, mitigating the market power of CRAs. Below we analyse 3 alternative approaches to assessing credit quality to understand whether they are suitable alternatives to credit ratings, and in turn to data feeds.

5.36 CRAs additionally told us that 2alternative credit risk measures that were emerging to potentially compete with credit ratings were investors' own internal risk assessments and third-party credit scores.

5.37 Stakeholders also highlighted that alternative market implied metrics such as credit default swaps (CDS) spreads, bond yield spreads and leverage ratios can potentially give a more accurate picture of credit risk.

Use of internal credit risk assessments

5.38 As mentioned above, large financial firms are expected to undertake comprehensive risk assessments for all assets on their balance sheet. This includes banks and insurers under CRR and Solvency 2, asset managers under UCITS and AIFMD regulation, and pension schemes under various different regulations. The following

looks at the viability of using internal assessment approaches to measure credit risk as a substitute for credit ratings.

5.39 With internal approaches, models measure common credit risk metrics such as probability of default, loss given default, and exposure at default. This analysis might use both statistical models and more qualitative opinions. Market-based metrics discussed below (such as pricing data and CDS spreads), and accounting-based indicators also frequently serve as inputs for internal analysis.

5.40 However, there are significant costs in terms of implementation, staff, and continued compliance. Our analysis found some prudentially regulated firms employ hundreds of staff to work on internal modelling. Where banks do have these sophisticated systems in place, it is typically feasible due to existing credit risk expertise relating to their traditional lending business.

5.41 Additionally, there can be barriers to data acquisition and processing, with publicly available data on borrowers often not extensive or standardised enough. Many third-parties offer products to support modelling, as well as external data sets, which may reduce implementation costs. This includes products available from data affiliates of the largest 3 CRAs and MDVs.

5.42 Even if not used as an input into internal models, there are multiple reasons why investors still use credit ratings:
- It is standard practice to benchmark and validate internal modelling against external analysis to avoid allegations of bias or conflict of interest. The most common, and accepted, form of independent credit analysis are credit ratings.
- Firms, particularly asset managers, need to communicate credit risk to clients in language they are familiar with, with the most common standard being credit ratings. Even when relying on internal analysis to model portfolio risk, there has been an increase in asset managers seeking fund level ratings from CRAs.
- Firms' internal risk models are proprietary and confidential, and many firms may prefer to keep them undisclosed to maintain a competitive edge, instead relying on credit ratings for external reporting to both clients and regulators.
- For CRR firms, Basel 3.1 implementation is expected to introduce an 'output floor' where firms will have to use credit ratings for capital calculations if ratings would result in a higher risk weighting for specific assets than that of internal models.

5.43 Our analysis found little indication that firms were moving away from credit ratings, nor that CRAs saw this as a viable threat to their business models in the medium term. Therefore, our view is that internal credit assessments are not currently an effective substitute for credit ratings, and internal and external approaches complement one another.

Use of market-implied ratings

5.44 A market-implied rating (MIR) is a credit assessment derived from the pricing and other market information on an issuance, rather than comprehensive analysis of an issuer's fundamentals. There are many different types of MIRs which are calculated from information including bonds yields, prices, CDS spreads, and other market indicators.

5.45   The required data is usually publicly available, and relatively cheap to both calculate and interpret. As they are based on market data, MIRs will react to changes in credit risk faster than credit ratings. As prices reflect market participants collective expectations about the future credit risk of an issuer, they are also forward-looking.

5.46   Following the 2008 financial crisis, there was discussion that MIRs, particularly CDS spreads, might be viable substitutes for ratings, as they seemed to reflect changes in credit risk much faster and accurately than credit ratings.

5.47   However, there are several limitations to using MIRs. They can be influenced by market volatility, liquidity issues, and investor sentiment, which may not always accurately reflect credit risk. Additionally, MIRs are derived from real-time information in the secondary market from the continuous trading of assets. As such, MIRs cannot be used to assess new issuances in the primary market, limiting their use to specific investor activities.

5.48   Though many investors may calculate MIRs to compliment credit ratings, or to use as part of their internal assessments, we did not find evidence that they are being used as a replacement for credit ratings. Therefore, we similarly do not see them as a substitute product for users of credit ratings data feeds.

Use of third-party credit scores

5.49   A credit score is a measure of creditworthiness, most typically of an organisation rather than a security, derived from summarising and expressing data based only on established statistical models, without any additional substantial case-specific analysis. These automated scores can be either produced based on publicly available information, or confidential information supplied by the credit score provider.

5.50   Several CRAs highlighted facing competition from the credit scores market, which are exempt from UK CRAR, and commonly created by both CRAs and unregulated firms.

5.51   Due to being purely computational, credit scores can be cheaper to produce and have much wider market coverage than credit ratings. One firm we engaged with, Dun and Bradstreet, had scores relating to millions of organisations globally.

5.52   Engagement with credit score suppliers found that credit scores were rarely used for investment decisions. More commonly they were to understand credit risk of their supply chain, clients, and other intermediaries. Most commonly credit scores were used for less complex lending to small and medium size firms. Less frequently, credit scores were used to complement firms' internal analysis of larger commercial loan decisions.

5.53   A notable limitation highlighted to using credit scores was their backwards looking nature, due to not implementing qualitative forward-looking insights taken from strategic documents or meetings with management. Typically bond investors implement buy and hold strategies, and credit scores are not viewed as being useful for predicting medium-long term credit risk. Additionally, whilst credit scores can be an input into internal risk assessments, they are not currently accepted for capital requirements calculations.

5.54   Overall, our analysis found limited evidence that credit scores were used as a viable alternative to data feeds and that they are not targeting the same market.

Free information sources

5.55   This section assesses whether free sources of credit ratings, particularly those available on CRAs' websites and databases maintained by regulatory bodies, can be used by firms for regulatory purposes. We are particularly interested in whether these free sources can allow firms to meet their regulatory requirements.

5.56   Under UK CRAR, public credit ratings are required to be disclosed on a non-selective basis in a timely manner. This serves to prevent unfair advantages that might arise from selective disclosure and helps maintain market integrity by providing all stakeholders, including investors, regulators, and the public, equal and timely access to ratings updates. The standard compliance practice for CRAs is to each maintain public websites where new ratings are published instantly, as well as enabling investors to sign up for notifications, and further providing these updates via MDVs. Additionally, this data is provided to the FCA for publication on the PRD platform, typically updated each business day.

5.57   Given the original, EU-specific version of CRAR applies within the EU, ESMA runs a similar database to PRD, known as the European Ratings Platform (ERP). We understand that at least initially, these databases were similar in terms of functionality, however given a different range of CRAs are regulated within the EU, the coverage on both platforms can differ.

5.58   Initially launched in 2016, these databases had 3 main goals:
- Lower information processing costs to regulators by centralising information.
- Allowing investors and other users of ratings to easily compare all credit ratings for a specific rated issuer or instrument.
- Helping smaller and new credit rating agencies gain visibility in the market.

5.59   There was no primary intention for these databases to be used by investors to analyse the ratings of multiple issuers or securities on an aggregate level. However, these databases have since been posited by both regulators and market participants as an alternative to data feeds, particularly for use in regulatory reporting and capital requirement calculations.

Free data as an alternative for users

5.60   We were interested in understanding whether free data available on CRA websites and regulatory databases is being used by market participants. Whilst 67% of respondents were aware of these free sources, only 43% were aware that the data from then could be used for regulatory reporting in the absence of a licence with a CRA. From our engagement with other regulators, we understand this may be as some of the largest CRAs have only recently clarified that their ratings can be used for regulatory purposes without a licence in the past 3years.

Figure 17: Awareness of free ratings

Aware of free ratings   Aware of regulatory reporting use

33%

67%

43%

57%

■ Not aware   ■ Aware
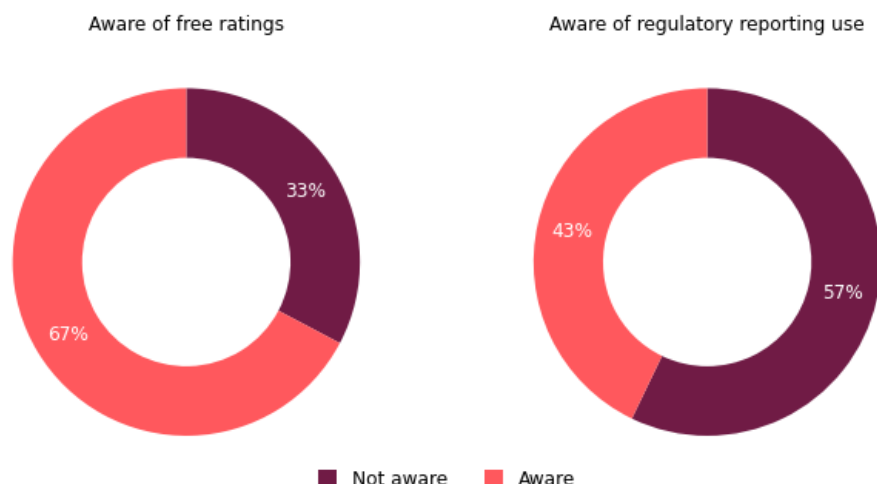
Source: FCA analysis of responses to our user survey

5.61 Some respondents suggested they could use free data for limited internal risk management purposes. However, many respondents found free data did not meet their regulatory requirements.

5.62 Users mentioned that there were restrictions on scale and type of use of free data. This includes:

- **Query limitations**: Some users require accessing ratings on a high volume of different issuers and securities. Regulatory databases only allow accessing a fraction of this, due to limitations on the amount of data that can be accessed in a single database request or in a given 24-hour period. This is in part implemented by regulators to prevent intensive data scraping, which can impact the performance of websites, as well as other security risks.

- **Regulatory use ambiguity**: Engagement with investment firms found it was unclear how regulatory use was defined. For example, asset managers may manage some aspects of regulatory reporting on behalf of banking and insurance clients, rather than directly having these requirements. Additionally, some use cases, such as categorising investments by credit ratings, is driven by capital requirements but forms part of commercial investment strategies.

5.63 Users of data feeds also mentioned practical barriers to using free data from CRA websites and regulatory databases. This includes:

- **Machine readability**: Users require data to be accessible in formats which can be processed by their internal systems. This includes file formats such as CSV, or via server querying such as APIs. Regulatory databases do not allow for this functionality, meaning users must instead manually extract and process the data before it is useable. Users state this is cumbersome and only suitable for one-off requirements.

- **Database structure:** Although ratings from different CRAs are available, they are not grouped together optimally. Instead, there is typically separate database entries for each respective rating on a security. Market reference codes, including

international standards such as ISIN and SEDOL numbers, which can be used for grouping data and merging with other datasets, are not consistently included.

- **Lack of customisation**: Users want the option to filter the data, or receive specific subsets, in certain formats at specific intervals to align with scheduled regulatory reporting. Currently regulatory databases only have rudimentary filtering capabilities.

5.64   Finally, users state limitations on the reliability, completeness, and speed of free data. This includes:

- **Liability for errors or downtime**: Due to resource constraints, there is no guarantee that regulators can constantly ensure that databases are kept up-to-date, and limited liability if they are unavailable or contain errors. Users relying on this data for regulatory or commercial practices may be more reassured being in a formal legal contract with a commercial data provider.

- **Limited data scope**: Regulatory databases typically only cover ratings issued or endorsed in a specific legal jurisdiction. Though coverage is typically aligned with the securities that are subject to capital requirements calculations, users can require broader coverage for sector risk monitoring.

- **Real-time requirements**: Many users saw data being updated in real-time as a market standard. Though not essential for regulatory reporting, quantitative models used for calculating capital requirements run 24/7, continually refreshing input data including credit ratings. Commercial data feeds are commonly refreshed every 15 minutes, whereas regulator databases are typically updated each workday.

5.65   Users also mentioned free data not providing access to important qualitative information to understand the rationale behind ratings such as research and commentary explaining ratings changes. Many users additionally require access to credit analysts working for CRAs.

5.66   Therefore, while most data feed users know that it is possible to use free sources of ratings data, there are many limitations to the widespread adoption of use. Most respondents suggested that free data is not currently a viable substitute for data feeds. Further, nearly all respondents stated that free data had no impact on their use of data feeds.

5.67   In summary, even when free data sources can be used for regulatory compliance, it is often more efficient for users to instead purchase commercial solutions such as data feeds.

Barriers to switching

5.68   This section analyses the levels of switching we observe from data feeds users and what the costs are for switching

5.69   Barriers to switching refer to the obstacles faced by existing users of credit ratings data feeds to change to alternative providers. The existence of high barriers to switching can increase the market power of incumbent firms with already high market share, allowing them to charge prices higher than competitive levels. For instance, if there is an alternative new provider who charges a lower price for the

same quality product compared to an existing firm, customers will likely not be inclined to switch if high switching costs offset the price difference of the products.

Switching levels

5.70 We asked users how long they had held data feed licences, and whether they switch between providers, and if so, under what circumstances. Around 80% of respondents suggested they have not switched between CRA data affiliates. Most respondents stated they had long-term relationships with the CRAs data affiliates they purchase data feeds from. This was typically more than 10 years and occasionally more than 20 years.

5.71 Of the respondents who had considered switching, most suggested that in practice, switching was rare, with only 17% switching between data feed providers.

Switching Costs

5.72 We wanted to understand switching costs and if they were a driver of the low levels of switching role. This section outlines the main switching costs raised by users.

Limited substitutability between the largest CRA data affiliates

5.73 Many users highlighted that due to coverage requirements relating to regulatory reporting and client mandates, they require credit ratings from all the largest 3 CRAs, and therefore, there is limited or no ability to switch.

5.74 Some respondents suggested that, where they do acquire data feeds from challenger CRAs, this will typically be in addition to their existing data feed providers.

5.75 Users suggested that they may switch between ratings for asset types, entities, securities or use cases, however, terminating a contract with the largest 3 CRAs' data affiliates is unlikely given their must-have nature.

Integration costs

5.76 Data feeds are often integrated into users' internal systems, typically by loading data into central databases. This includes risk management, portfolio management, compliance, and regulatory reporting systems. Users stated integration differs depending on the access channel, eg daily downloads, APIs, real-time feeds, and ad-hoc manual access.

5.77 Switching data feed providers can create integration costs that might deter firms from switching. Onboarding a new provider involves negotiating fees, removing current suppliers and integrating new data into internal systems. If the switch results in using a different CRA, investment mandates might have to be updated to reflect this change.

5.78 Respondents had mixed views regarding the time is usually takes to switch providers, ranging from a few days to 3years. A number of respondents distinguished between the shorter time taken to onboard a new supplier rather than switching between providers.

Termination costs

5.79   We asked users if the service agreement with their current data feed provider needed to be terminated what the impact would be.

5.80   Many users suggested they can only terminate a contract by providing sufficient notice, often 45-90 days in advance of contract renewal, else they would be liable for the full remaining term of the contract. Therefore, early termination is unlikely.

5.81   Several respondents also identified the requirement to remove historical data from the existing data feed provider as a barrier to switching. Users suggested removal creates an audit trail risk. Users also suggested audits of their firm to ensure all data is purged from systems are difficult and costly.

Other switching costs

5.82   Respondents suggested other significant switching costs:

- Search and evaluation costs of sourcing a new provider.
- Drafting and approving internal business cases.
- Negotiating with new providers and contractual work involved.
- Due diligence and testing.
- The need to for a period of side-by-side testing where both data feed providers overlap.

Summary of switching costs

5.83   Users reference multiple costs associated with switching data feed provider. However, limited switching is predominantly driven by CRAs complementary value exceeding cost savings from substitutability, particularly for the largest 3 CRAs.

Bargaining power

5.84   This section analyses how much influence users have when attempting to negotiate with CRA data affiliates and whether this is mitigating the pricing power of providers.

Negotiation levels

5.85   We asked users if they had attempted to negotiate licence fees with CRA data affiliates, either at the initial point of sale, or upon contract renewal. The vast majority of users (96%) suggested they attempted to negotiate pricing at contract renewal, however, 76% suggested they had limited success. This can be seen in Figure 18.

Figure 18: Negotiating with CRAs data affiliates
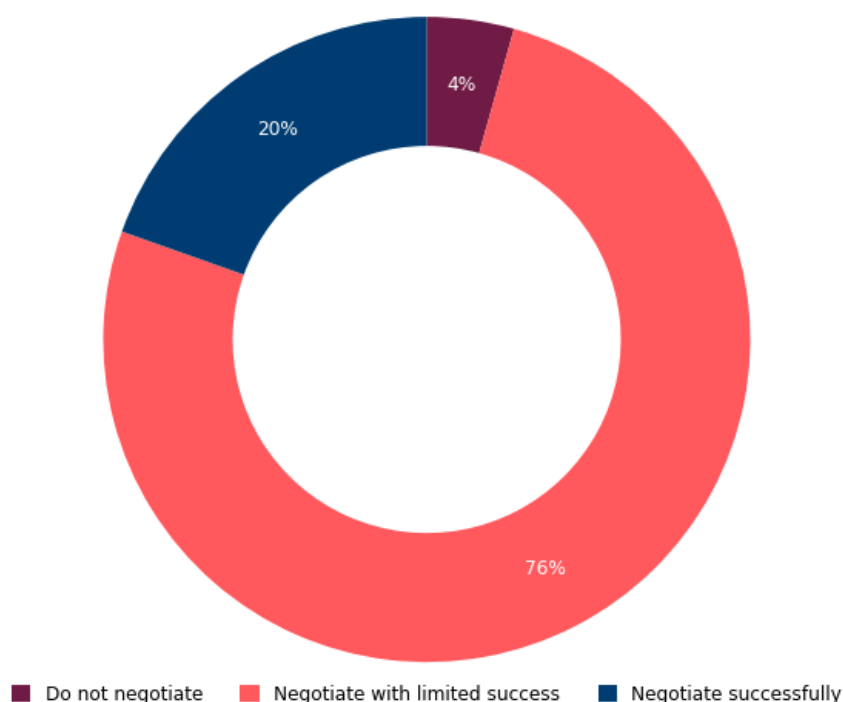
Source: FCA analysis of responses to our user survey

Drivers of limited negotiations

5.86 Users identify multiple reasons for their limited ability to negotiate with CRA data affiliates. The main reasons mentioned were as follows:

- **Rigid fee structures:** CRA data affiliates tend to be inflexible in their pricing models and only offer minimal concessions. Some users suggested pricing was based on fixed criteria they had limited ability to negotiate over, eg the user's total revenue or fixed income assets under management (AuM). 50% of users that had limited success in negotiating stating that this rigidity was a reason.

- **Limited choice:** Users have limited ability to switch between suppliers and are often required to multi-source from the largest 3 CRA data affiliates. This means they cannot threaten to switch away from suppliers to attempt to reduce prices. 28% of users that had limited success in negotiating stated that this limited choice was a reason.

- **Limited price transparency:** Data affiliates are not obliged to, and typically do not, publicly disclose data feed prices. 41% of users highlighted this limited price transparency, with over a third of these users feeling unable to compare what they pay to other suppliers or other users with similar data needs. 19% of users that had limited success in negotiating stated that price transparency was a reason.

5.87 A few firms mentioned additional reasons:

- Regulatory requirements make purchasing data feeds essential, meaning users have limited ability to threaten to switch away, reducing their bargaining power.
- Risks associated with an interruption in service limit users' ability to terminate a service or switch to an alternative provider.

5.88 Users found that negotiating multi-year contracts with pre-defined annual price increases was the main way to secure discounts. Around 80% of users hold a multi-year contract for data feeds, typically 2 or 3 years in length.

5.89 Overall, firms have limited bargaining power, and this has resulted in few firms successfully negotiating with CRA data affiliates to drive down prices. Where firms do negotiate lower fees, it usually requires them to sign a multi-year contract, locking customers into a longer contract than they may require.

Barriers to entry or expansion

5.90 Barriers to entry or expansion refer to the structural or strategic impediments of the market that make it costly or difficult for new or existing firms to gain market share. These entry barriers may be due to the advantages of existing firms resulting from coverage requirements, brand reputation or switching costs. This section analyses the barriers to entry firms face when entering the data feeds market, with reference to the issuer services market where relevant.

5.91 In this section we assess the barriers to CRAs commercialising their credit ratings into data feeds. We discuss 3 main areas: coverage, reputation, and other barriers.

Market coverage

5.92 The crux of what makes data feeds valuable to investors is the comprehensive coverage of different geographic regions, economic sectors, and asset classes. For the largest 3 CRAs, coverage is possible due to their high market share of the global issuer services market. For challenger CRAs to compete in the data feed market with the largest 3 CRAs, they would need to significantly increase their global market coverage. However, there are barriers to achieving the required levels of coverage.

5.93 Barriers to gaining market coverage via competing in the issuer services market are covered in more detail in Chapter 3, but include the following:

- Issuers are price inelastic for issuer services from the largest 3 CRAs. Credit ratings are essential for many issuers for a multitude of reasons. Market participants have consistently mentioned how the value gained from acquiring ratings from the largest 3 CRAs far exceeds the costs of maintaining ratings. This inhibits smaller CRAs being able to compete with the largest 3 CRAs using a low pricing strategy.
- Given the resource intensive nature of the ratings process for issuers, including regular data requests and demands for senior management from ratings analysts, issuers may not have the capacity to maintain additional ratings.
- Issuers benefit from being rated by the same CRA over the long term to allow for historical comparisons and a consistent, continuous record of an issuers'

creditworthiness. This makes it difficult for challengers to encourage issuers to switch to a CRA with a different ratings methodology.

- Issuers have covenants within contracts with lenders and investors that require them to maintain a certain credit rating from a specific CRA. Switching to challenger CRAs could be in breach of these contracts.

5.94 Challenger CRAs could increase market coverage instead by using an unsolicited ratings strategy. Challenger CRAs have historically used unsolicited ratings to demonstrate their analytical capabilities and convince issuers covered by their unsolicited ratings to become paying customers.

5.95 However, multiple barriers exist to using a similar unsolicited ratings strategy purely to gain the coverage needed to compete in the data feeds market:

- To reach the coverage levels required to develop a rival data feed, challengers would need to maintain thousands of unsolicited ratings to build up legitimacy, at significant cost. Given the relatively small revenues of the data feeds market relative to the cost of generating ratings, it is unlikely to be a profitable long-term strategy.

- Investors are reluctant to rely on unsolicited ratings due to the perception that they are of a worse quality than solicited ratings. This is mainly due to being created exclusively using public information, which could be freely analysed by investors. There is also a lack of incentive for CRAs to maintain unsolicited ratings.

- Unsolicited ratings have historically been on instruments that have already been rated by other CRAs on a solicited basis. Therefore, users of data feeds will have little incentive to purchase data feeds from challengers instead of using the largest 3 CRAs' solicited ratings.

Reputation and market acceptance

5.96 The largest 3 CRAs have built up a reputation with both issuers and investors over decades. Whilst reputational damage caused in the 2008 financial crisis particularly impacted the largest 3 CRAs, it led to criticism of credit ratings more generally. Post financial crisis the largest 3 CRAs in part retained their market position due to having proven, testable methodologies across thousands of monitored ratings.

5.97 Our survey found 77% of users preferred the largest 3 CRAs due to a perception of their quality, plus market familiarity and acceptance of their rating methodologies. Similar considerations were expressed in direct engagement with both suppliers and users.

5.98 Some market participants highlighted that challenger CRAs have been historically perceived as giving relatively higher ratings. Issuers acquiring challenger ratings in the absence of also acquiring a rating from one of the largest 3 CRAs can be perceived negatively by the market. Particularly, this criticism can occur if switching is perceived as an attempt to acquire a higher rating, known as 'ratings shopping'. This is harmful for an issuer's reputation and often means issuers feel compelled to prioritise maintaining ratings with the largest 3 CRAs, disadvantaging challenger CRAs.

5.99   Our evidence shows that both investors and issuers perceive the largest 3 CRAs to be the market standard when choosing a CRA. It would take a considerable amount of time and resources for challenger CRAs to develop the reputation and market acceptance required to compete with the largest 3 CRAs in the issuer services market, and in turn the data feeds market.

Other barriers

5.100   Outside of barriers caused by market acceptance and coverage, barriers to investors using challenger CRAs' ratings include:

- Investors are expected to understand the methodologies of individual CRAs before incorporating their ratings into their risk management processes. This requirement is not just a best practice but is also mandated by regulation in many jurisdictions. Given time and analytical constraints, firms may prioritise understanding the methodologies of the most established CRAs.

- Similarly, by focusing on a few CRAs, investors can ensure a level of consistency and comparability in the credit risk assessments across their portfolios. This can simplify risk management and investment strategy across different sectors or geographies.

5.101   The debt issuance process is highly complex, involving numerous third-party intermediaries including underwriters and legal firms, who have their own relationships with CRAs. We engaged with these intermediaries to understand the influence they have might on issuer choice of CRAs and whether smaller CRAs may be disadvantaged by these intermediaries demonstrating a preference for ratings from the largest 3 CRAs.

5.102   Underwriters, typically investment banks, play a significant role in risk assessment, pricing, and marketing of new debt issuances. Engagement with both issuers and underwriters confirmed that underwriters consistently played an impartial role in the exact choice of CRA, and any decision to acquire ratings from multiple CRAs. The same impartiality was found for legal firms, who play an equally crucial role in the regulatory and compliance aspects of new issuances.

5.103   However, we did find challengers experienced barriers to entering the data feeds market in the following areas concerning benchmark indices and MDV platforms:

- Fixed income benchmark requirements: Globally, trillions of pounds of debt securities are held in portfolios tracking fixed income benchmarks. Many major fixed income benchmark providers require securities included within the indices to have ratings from 2of the largest 3 CRAs. This may indirectly pressure issuers who wish to be included in an index for market access to prioritise ratings from the largest 3 CRAs.

- Visibility of smaller CRAs on MDVs: When accessing data on MDVs, ratings from the largest 3 CRAs are prioritised and usually visible as standard. Ratings from other providers are often optional or unavailable. MDVs and CRAs have said this is a reflection of the lack of demand to view ratings from challenger CRAs. However, this limited visibility may reinforce the position of the largest 3 CRAs.

5.104   These additional barriers to challenger CRAs for benchmark eligibility and positioning within MDV products can limit their ability to expand in the CRA issuer services market.

6 Market Outcomes

6.1 In this chapter, we assess market outcomes in light of the features of the market identified above.

Evidence of Market Power

Market Concentration and Entry

6.2 Our analysis of financial information found that the issuer services and data feed markets are both highly concentrated, with the largest 3 CRAs and their data affiliates holding combined market shares above 90%. For additional details on the market share assessment, please see the accompanying Financial Analysis Annex.

Figure 19: Estimated relative 2022 market shares of the largest 3 CRAs and Challenger firms in UK CRA issuance and CR data markets
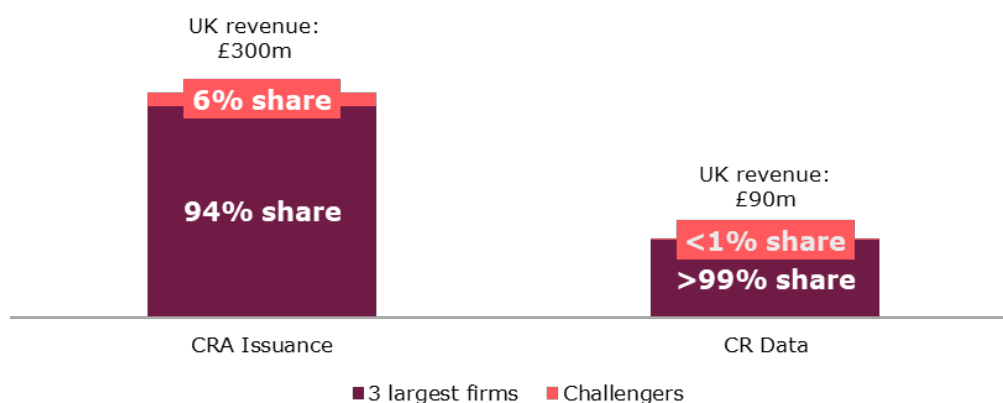
6.3 While there have been several entrants into the UK issuer services market in recent years, as of 2022 only a 6% share of revenues from issuer services were attributable to challenger CRAs. No challenger CRA had more than a 3% share of the market. This does not include revenues generated from ancillary services.

6.4 Only 2 challenger CRAs were selling data feeds to UK users, either directly from the CRA or via data affiliates. These challengers accounted for less than 1% of the estimated £90m revenue generated by UK data feeds in 2022.

Profitability levels

6.5 We have assessed the profitability of CRAs and their affiliates based on analysis of financial data. We examined the returns generated and compared these with cost of capital estimates.

6.6 Due to the limitations of the financial information provided, analysis is based on total operating costs and capital held by the firms selling data feeds to UK domiciled users. We have estimated the profitability of data feeds based on additional qualitative and financial information provided by select firms.

6.7 Over the 6-year period 2017-2022, operating profit margins of the largest 3 CRAs averaged over 40% and sometimes exceeded 60%. In contrast, the profit margins of challenger CRAs rarely exceeded 25%.

6.8 Analysis of return on capital employed (ROCE) corroborated these findings. In every year throughout the 2017-2022 period, the largest 3 CRAs achieved returns significantly above our estimates of their cost of capital. Some challenger CRAs also generated returns exceeding their cost of capital, but this was to a lesser degree and varied more year-on-year.

6.9 CRAs' data affiliates demonstrated lower profitability than CRAs, with profit margins of the largest 3 data affiliates averaging slightly above 30%, and lower amongst the affiliates of challenger CRAs.

6.10 This analysis likely underestimates profitability of data feeds for 2 reasons:
- We found that royalties paid by data affiliates to the CRA issuance business accounted for around one-third of data affiliates' total operating costs, one of the largest expenditures incurred by data affiliates. These royalties directly impact operating profit margins. Our evidence shows that, while such financial transfers are determined on arm's length basis, these payments may include a profit mark-up.
- Data affiliates, particularly of the largest 3 CRAs, offer products other than data feeds, which can be purchased independently of data feeds. We found, based on evidence from only a subset of sample firms, that a significant proportion of data affiliates' staff costs relate to commercial and support functions, rather than being primarily focused on the production of CR data content. Based on this evidence, other analytical products offered alongside data feeds appear more staff intensive, requiring substantial resources for product development and content production.

6.11 Overall, we estimate that product level profit margins of the data feeds sold by the largest 3 data affiliates may be as high as 46%. Analysis of return on capital employed (ROCE) further indicates that throughout 2017-2022 data affiliates achieved levels of profitability well exceeding cost of capital. This demonstrates an ability for the largest data affiliates to generate a return on investment above their cost of capital which would be competed away in a competitive market and therefore suggests a degree of market power.

Quality of credit ratings and data feeds

6.12   We asked users for their views on the accuracy or quality of ratings provided by the largest 3 CRAs (S&P, Moody's, and Fitch). Generally, users were neutral to positive about the quality and accuracy of service provided by the largest 3 CRAs, highlighting strengths and weaknesses. This can be seen in Figure 20.

Figure 20: Largest 3 CRAs quality sentiment analysis
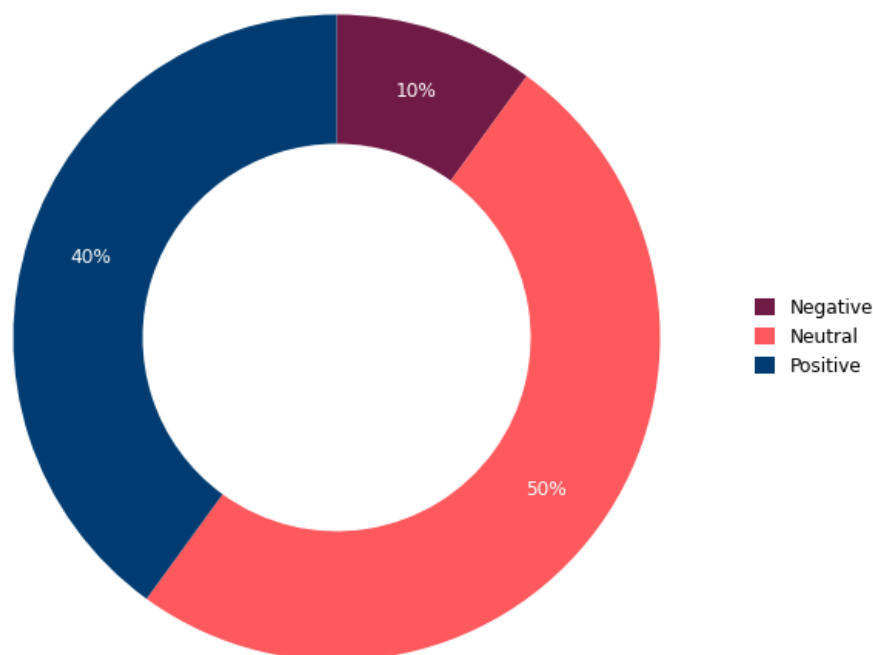
Source: FCA analysis of responses to our user survey

6.13   40% of respondents were positive about the largest 3 CRA's rating accuracy and quality, stating they meet expectations due to their:

- Wide, global coverage they provide. Although, responses varied about the coverage quality of the largest 3 CRAs, with some having sector specific strengths.
- Regularly updated individual ratings and wider sector methodologies.
- Consistency and reliability.

6.14   10% of firms responded negatively, raising issues with the quality and accuracy of ratings and other services provided by the largest 3 CRAs. This included:

- Historic failures in accuracy and quality.
- Growth in ratings coverage at the potential expense of analytical quality.
- Limited predictive power of ratings.

6.15   We also asked users for their views on the quality of smaller CRAs. In general, respondents had less experience of smaller CRAs and limited views on their quality.

However, those that had, highlighted their use in providing coverage in specialist areas or geographies.

Innovation

6.16 In a competitive market we would expect firms to innovate in ways that allow them to better compete with rivals and win customers. We assessed qualitative evidence of innovation in the data affiliate market to understand how market power is impacting firms' incentive to innovate. This assessment does not involve quantitative analysis of investment levels.

6.17 As previously mentioned, as standard, data feeds include the following components:
- A database of ratings beings accessed, typically updated in real-time.
- A channel for accessing the data, such as CRA software, an MDV, or an API for querying a server.
- The licensing agreement that the underlying ratings can be used for specific operational purposes.

6.18 We asked suppliers to outline any significant changes or cost increases in the provision of data feeds in the past five years, including investments they have made to improve their data feed service. Areas of investment for the largest 3 CRAs mainly involved improvements to their distribution platforms, eg opening up API and Secure File Transfer Protocol (SFTP) capabilities. This provides more opportunities to make their feeds interoperable with 3rd party systems to increase distribution of their ratings.

6.19 CRA data affiliates also invested in the quality of their data feed ratings database through:
- Adding new datasets, eg ESG and Cyber.
- Adding new identifiers for mapping data, eg legal entity identifier (LEI).
- Enhancing reliability, eg improved cyber security or reduced website downtime.

6.20 Challengers have invested in some technological advancements, however, generally have not made significant changes to their product offering in the past 5 years.

Artificial Intelligence

6.21 Over the past year, the application of artificial intelligence (AI) in retail lending decisions has garnered significant interest by the media, regulators, and market participants. AI has the potential to significantly impact analytical techniques and possibly enhance the rating process. In our engagement with suppliers, we found there were no short-term plans for AI to be integrated into their issuer or data feed services. However, they were all at the early stages of exploring the emergence of AI and the impact on the services they offer.

6.22 It was seen that, while AI could enhance analytical capabilities and efficiency, the judgment and industry knowledge of CRAs could not be easily replicated by algorithms. Additionally, credit ratings rely on confidential data that required existing relationships to be formed with issuers. Firms also suggested that there were

challenges with understanding the decision-making processes of AI models, with the resulting lack of transparency impacting bias and accountability. As such, it was viewed as unlikely AI credit risk models would gain regulatory acceptability in the short term.

6.23   One CRA suggested that current discussion around AI's impact on credit ratings was analogous to the interest in CDS spreads being used as a measure of credit risk in the mid-2000s, which led to innovative risks strategies in the short term but did not fundamentally alter the core process of credit ratings.

7 Commercial practices and impact on end users

Introduction

7.1 This section assesses the impact of the largest 3 CRAs' data affiliates' market power through their commercial practices, and how this could be generating harm for users of data feeds and their end-clients.

User expenditure on data feeds

7.2 Weak competition can give suppliers the ability to set prices significantly above the levels that might be expected in a competitive market.

7.3 We have looked at the revenues earned by data feed providers from individual customers. This presents some challenges. Due to the way that prices are set and the nature of data feed usage there is no commonly accepted measure of price per unit of data. Instead, we look at the cost of data feeds to users based on the total revenue that a user pays its supplier. Our analysis therefore focuses on changes in the revenue generated per customer. This necessarily has the limitation that it does not consider whether users are obtaining increasing amounts of ratings data through data feeds. Set against this, we note that 70% of firms in our user survey state that their usage of data feeds has remained broadly unchanged over the last 5 years.

7.4 We analyse the common pricing parameters of data feeds that lead to users paying and discuss the extent to which we observe high and increasing revenues charged per user in the provision of data feeds.

7.5 In this section, we report the findings from our analysis of transaction level data provided by CRA data affiliates. Allowing us to consider the distribution in customers' data feed expenditure and trends over time. We report expenditure aggregated at the customer level, as a given customer might have more than one contract in place at any point in time.

Expenditure varies across customers

7.6 We were interested in understanding how the price of data feeds is determined by CRA data affiliates, and how this impacts prices paid by market participants.

Price factors

7.7 There is no standardised pricing methodology for credit ratings data feeds. CRA data affiliates price data feeds based on a variety of factors based on perceived value to users. These pricing factors included:

- The volume of data delivered, eg, by firm size, per user, location, and asset class.

- How data feeds are used, eg, when data is used internally in regulatory reporting or externally through the redistribution of credit ratings data.
- How data is delivered, eg, the number of and type of access channels, and the frequency of data updates and delivery.

7.8 Challenger CRAs and their data affiliates licensing terms tend to focus on volume of use. The largest 3 CRAs' prices are more complex, based on most of, if not all, the above factors.

Discounts

7.9 CRA data affiliates may operate a discount policy where they offer reductions on data feed licensing fees when firms agree to sign multi-year, multi-product, or enterprise contracts, amongst other discounts.

7.10 Respondents suggested that agreeing multi-year contracts with pre-defined annual price increases was the main way they attempted to negotiate discounts and provide pricing certainty. Around 80% of users suggested they hold a multi-year contract with data affiliates, typically up to 3 years in length.

7.11 Few challenger CRAs and their data affiliates offer discounts, while the largest 3 CRAs' data affiliates offer a wide range of discounts.

Variation in revenue per customer

7.12 This pricing model leads to significant variation in revenue per customer both within firms and between different firms.

7.13 Figure 21 shows the distribution of expenditure across clients at the largest 3 CRA data affiliates. As we would expect there is a long tail of customers who pay relatively low amounts across each firm. There is significant variation in expenditure across customers with the highest-spending customer in 2022 paying many times more than the mean expenditure per customer at the same provider (Figure 21 capped at 8 for readability). There is variation between the largest providers in the distribution of customers who pay prices above the mean expenditure per customer. However, across the largest affiliates, around 80% spend below the mean expenditure per customer.

7.14 Users paying the most are generally large multinational firms who often purchase data feeds from multiple CRAs. Customers paying below the mean expenditure were generally smaller with limited data requirements, such as boutique asset managers and small consultancy firms.

Figure 21: Breakdown of CR data customer expenditure in 2022 across the largest 3 CRAs
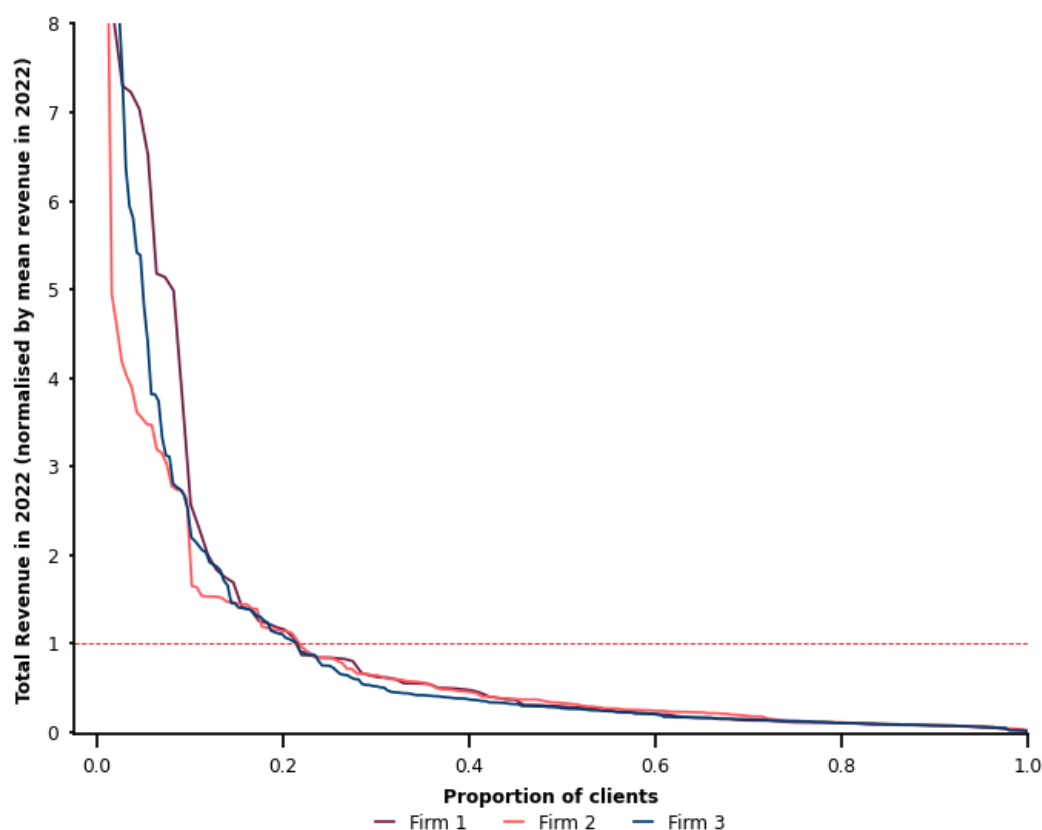
Source: FCA analysis of CRA transaction level data. The y axis on this graph is capped at 8 for readability.

7.16   Overall, we observe a significant degree of variation in customer expenditure. Further, several firms were unable to provide us with a specific price list. Instead, they base their pricing on a range of factors built into internal models, which they have significant discretion to adjust. Data feed suppliers provide customers with limited transparency over what drives the prices they charge and discounts they offer. This makes it likely that data feed users with similar characteristics and usage of credit ratings data are paying significantly different amounts.

Expenditure has increased over time for many users

7.17   Given the finding that customers pay varying amounts for data feeds, we now analyse how revenues per customer have changed. This supports our understanding of whether CRA data affiliates are exerting their market power to increase prices for data feed users.

7.18   We have analysed how customer expenditure has changed over the period 2017-2022. We found that most data feed customers paid more in 2022 than in 2017. These increases were only partially accounted for by leading measures of inflation, including CPI. The total expenditure of 42% of customers in our dataset increased more than 50% (see Figure 22), and a further 36% of customers faced increases in

total fees above inflation but less than 50%. This is based on a cumulative inflation rate of 17.7% across the period, which is calculated using the Consumer Price Index.

7.19   The distribution of total expenditure growth is similar across the largest 3 CRAs. The vast majority of clients experienced an increase in total expenditure above the rate of inflation for the period across the largest 3 CRAs.

Figure 22: Change in total expenditure per customer for the largest 3 CRAs
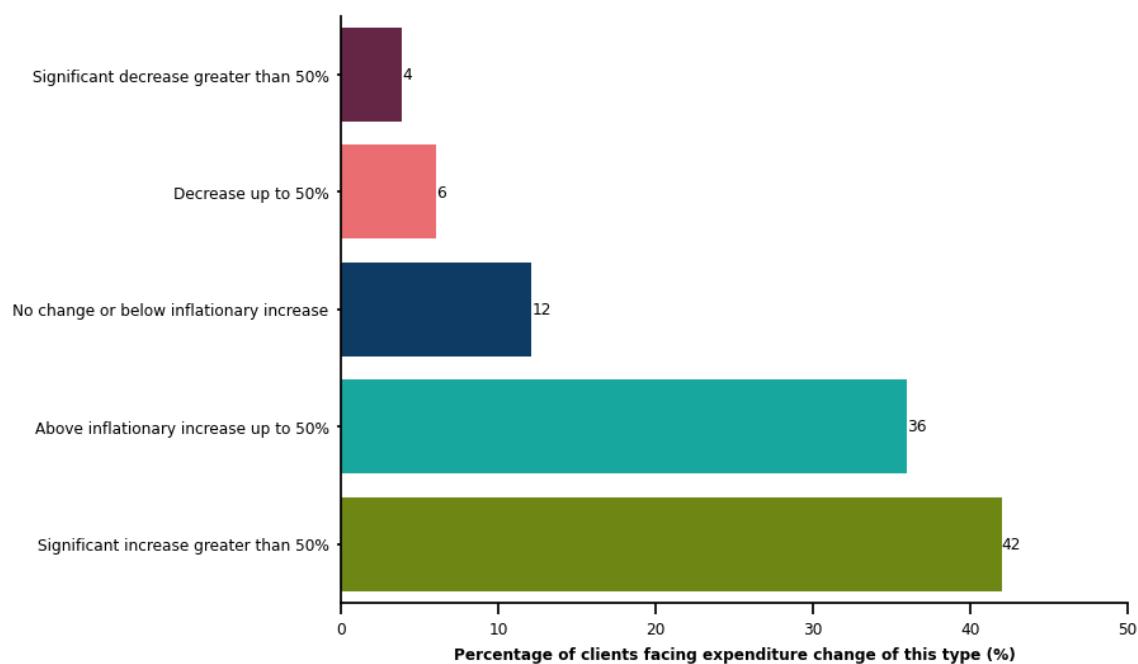
Source: FCA analysis of CRA transaction level data. This data includes only customers who purchased services from a given provider across the whole period. Note: the cumulative inflation rate across the period was 17.7%. This is calculated using the Consumer Price Index.

7.22   The top 20 revenue-driving clients of the largest 3 CRA data affiliates saw average expenditure per client increase significantly, with between 24% and 90% increases in average expenditure from 2017 to 2022. This indicates that neither large nor small users have sufficient bargaining strength to resist increases in cost in their negotiations over contractual terms with their data feed suppliers.

Customer perceptions

7.23   We asked users about any contractual changes in the past five years which had led to an increase in overall fees paid, including price increases for typical data licences or a requirement for additional licences due changes to usage agreements.

7.24   Over 90% of users had seen increases in overall fees paid for data feeds. Most respondents suggested that suppliers gave little justification for the price increases, which were typically above the rate of inflation. Respondents perceived no corresponding improvement in the scope of data, quality of services, or other innovations which may increase the value of data feeds.

7.25   Service price increases above inflation are not necessarily reflective of anti-competitive practices, particularly if a firm's own costs are outpacing inflation. Where data feed providers did provide a justification for price increases, it included the following:

- Increased data usage by individual customers, typically due to the number of data feed users within a company increases, or that data feeds are being integrated into additional internal systems.

- A change in the user's firm characteristics, given pricing is typically directly linked to firm revenue and fixed assets under administration (AUA).

- Users wanting to access data feeds through additional access channels including APIs, software terminals or MDVs.

- Users switching to a simpler enterprise licensing model, which is more expensive but has less complex contractual limitations

- Suppliers investing in improvements to the data feed.

7.26   Many respondents suggested credit ratings data is essential, given regulatory requirements or client demand. Therefore, irrespective of costs they will have to purchase data feeds covering ratings of the largest 3 CRAs. Knowing this, data affiliates of the largest 3 CRAs have limited incentives to improve the value proposition. Several respondents suggested value does vary across providers but making value comparisons across providers was difficult given a lack of pricing transparency and ability to benchmark against peers, and often a lack of choice over which providers they must use.

7.27   Given the limitations of assessing revenue per customer, our survey analysis supplements our findings that CRA data affiliates are increasing prices irrespective of changing usage by firms. This results in users feeling they are getting poor value for money. 62% of firms felt they were getting poor value from their current data feed fees. This can be seen in Figure 23.

Figure 23: User perceptions of data feed value
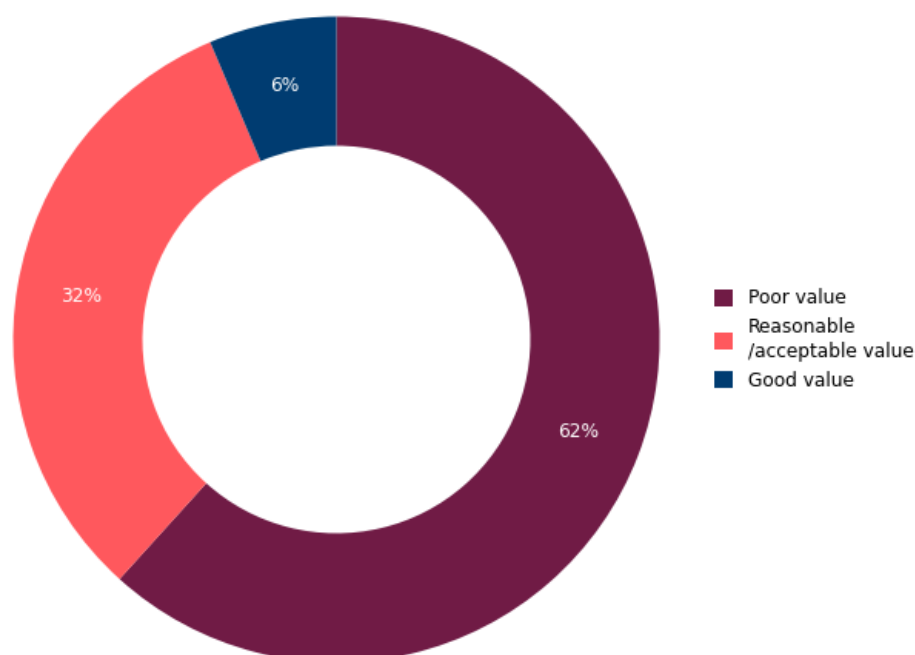
*Source: FCA analysis of responses to our user survey*Complex, non-standard and non-transparent licensing terms

7.28 A lack of standardised licensing for data feeds can contribute to prolonged fee negotiations and complex data usage restrictions. This section analyses whether users feel as though their contract and licence terms with CRA data affiliates are transparent, unambiguous, and reasonable.

7.29 37% of respondents suggested they had few or no concerns over data feed licencing terms, often suggesting they are transparent, reasonable, and clear. A few firms state that contracts are developed between both parties and reviewed by relevant legal teams to ensure they are fit-for-purpose.

7.30 63% of respondents identified a concern over contract and licence terms. Predominantly, these firms suggested their concerns related to confusing and opaque pricing models.

7.31 A minority of users highlighted the perceived complexity and unfairness of usage-based charges. This included concerns with:

- Fees associated with different delivery channels, particularly for accessing data feeds via MDVs.
- Extensive 'statements of use' documents that are burdensome to complete.
- Additional charges for new use cases identified at the time of contract renewal.
- Ambiguous use case definitions that are open for interpretation.

7.32 In summary, of those users concerned about the complexity, ambiguity and transparency of licensing contracts, the majority are concerned about pricing transparency that limits bargaining power as opposed to contracts themselves. Some users do highlight issues with how CRA data affiliates charge for different use cases and the ambiguity associated how use cases are defined. However, most firms find contracts straightforward, unambiguous, and transparent.

Bundling

7.33 Bundling refers to the way products are packaged and sold to users. For pure bundling, several products are jointly sold in fixed proportions. In the case of mixed bundling, products may be sold separately or as a package.

7.34 Bundling is a common commercial practice across industries and may provide benefits to consumers through lower transaction costs: being able to buy related products together lowers search efforts and may result in a lower price than if these products were purchased separately. However, bundling practices may have an adverse effect on competition through increasing barriers to switching, entry or expansion.

7.35 We were investigated how prevalent bundling data feeds with other ancillary services is, and whether this is distorting competition in an adverse way.

7.36 CRA data affiliates offer a number of ancillary services. The main ancillary service is credit analytics, which provide additional research beyond a credit rating. Investors purchase these services for a more in depth understanding of market trends, eg to better understand the emergence of ESG and its association with credit risk.

7.37 80% of respondents to our survey indicated that data feeds are not bundled with these ancillary services. Therefore, they would be able to terminate the use of ancillary services without impacting the price of their data feed subscription.

7.38 Some respondents suggested this was not the case for all CRA data affiliates, with users concerned that terminating their ancillary services may impact multi-product discounts they had negotiated. However, given the complementary nature of using data feeds and ancillary services, bundling these products together may yield benefits for some users.

7.39 In summary, product bundling is uncommon for CRA data affiliates. Where products are bundled together by some data affiliates, users may yield some benefits given the complementary nature of credit ratings and ancillary services.

Price Discrimination

7.40 It is common for data providers to charge users different amounts for using the same data, but for a different purpose.

7.41 CRA data affiliates often charge differently based on firm characteristics, including revenue size, industry sector, and usage volume, resulting in varied pricing structures tailored to each user's specific attributes and the perceived value a user derives from data feeds.

7.42 Value pricing is not necessarily harmful in the market for data feeds. For example, charging based on AuM will result in smaller boutique asset managers paying less than large, multi-national asset managers. Indeed, across the largest 3 data affiliates, 80% of customers paid below the mean price for data feeds. Such prices may be widening access in this market.

Pricing for redistribution

7.43 In Chapter 5, we found that MDVs are not a source of independent competitive pressure on the CRA data affiliates in the provision of data feeds. Instead, MDVs license with CRA data affiliates in a similar way to other data feed users.

7.44 Engagement with the largest MDVs has confirmed that comprehensive coverage of financial markets is the key parameter for clients choosing an MDV platform. Therefore, MDVs are required to purchase data feeds from data affiliates for comprehensive information on fixed income markets. This limits the bargaining power of MDVs and, similar to other market participants, limits their ability to negotiate pricing and licensing terms.

7.45 This results in MDVs:
- Paying increasing revenues to CRA data affiliates to redistribute credit ratings data. Although we have seen evidence of MDVs with revenue sharing agreements with the largest CRA data affiliates, generally these are minimal in comparison to total fees paid.
- Holding restrictive licensing agreements that allow them to redistribute data to their own clients but determine the volume (and other) thresholds above which an end user must license with the CRA data affiliate directly, rather than with the MDV.
- Holding licensing agreements that allows invasive audits to be conducted or requires MDVs to provide CRA data affiliates with extensive information about MDV's client base on an ongoing basis. Although, this is not common across all data affiliates.

7.46 While there can be justified reasons for these commercial practices, they can lead to inefficiencies. By increasing compliance costs for MDVs and potentially distorting downstream competition due to restricted user access to data feeds and increased costs that may be passed through. This could have adverse effects for investors and capital markets more widely.

Impact on end users

7.47 Rising prices for data feed users impact many wholesale market participants in the supply-chain. Data feed users produce supply investment products and services, eg, asset managers, banks, and insurance firms. End-users, both retail and institutional, then consume these products and services.

7.48 This section analyses the extent to which increases in the cost of data feeds impacts the investment products and services that data feed users' own customers purchase.

Impact of data feeds on investors' own services

7.49   We asked users if data feed costs were a material consideration in how they price their own product offerings, results of which can be seen in Figure 24. 78% of respondents suggested that data feed costs don't impact their own product pricing. A number of users suggested data costs are a fixed cost of doing business and at current levels are not a material component of their overall cost base. Therefore, costs are not generally passed on to clients.

7.50   Some respondents suggested downstream competition limits their ability to pass on costs due to the risk of losing clients. Although, some mention that passing down costs may be necessary if fees continue to rise.

7.51   Of the respondents who suggested data costs do impact their product pricing, most users highlighted that data more generally is an increasingly significant cost of doing business. Users seek to absorb a proportion of price increases; however, material increases in overheads impact client pricing over time.

Figure 24: Cost pass-through
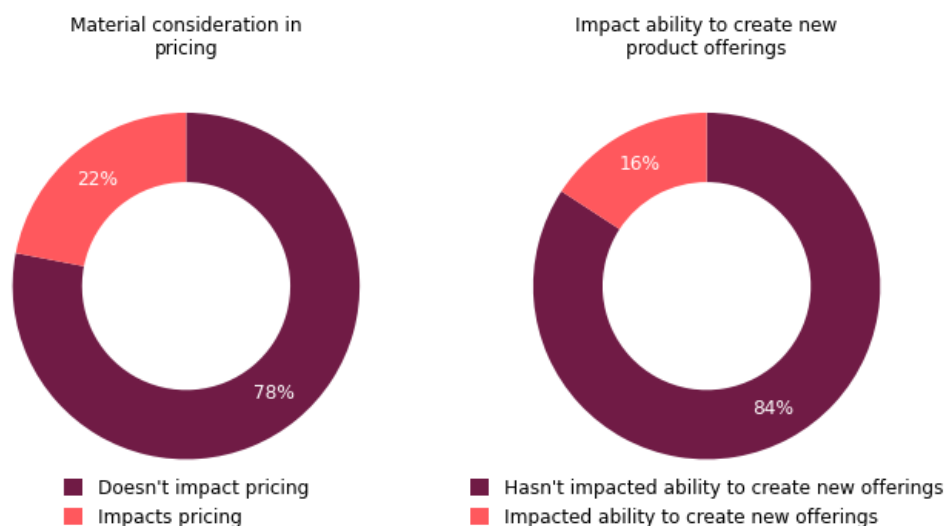
Source: FCA analysis of responses to our user survey

7.52   We asked users if changes to the cost of data feeds affected their ability to create or develop new products. 84% of respondents suggested these costs did not impact their ability to develop new products. However, some respondents suggested as prices are increasing, it is becoming prohibitive to develop existing products and provide better services to clients.

7.53   The small proportion of users suggested costs can impact their ability to create new product offerings and the commercial viability of existing products. Specifically, users stated that high data costs influenced decisions on whether to launch lower cost, passive products that require scale to become commercially viable. Some users suggesting high redistribution fees have influenced their decision not to offer redistribution services.

7.54 Finally, we asked users if they had withdrawn any products of services due to the increasing cost of data feeds. Nearly all respondents suggested data feed costs had not resulted in the withdrawal of products and services, although some users identified changes they have made to reduce their costs. This includes reducing the number of users, or withdrawing access to specific geographic sites.

7.55 Overall, our findings show there is limited evidence of high prices materially impacting downstream prices or firms' ability to launch new products of services. There is almost no evidence of firms withdrawing products due to high costs. Firms tend to absorb costs due to the competitive nature of downstream competition. However, firms state if prices continue to rise then this is likely to change.

8 Glossary of terms and abbreviations used in this document

Term	Definition
AuM	Assets under Management
BOE	Bank of England
CRA	Credit Rating Agency
CRR	Capital Requirements Regulation
CQS	Credit Quality Score – a score used to decide the amount of capital required to be held by CRR compliant firms for a given asset
ECAI	External Credit Assessment Institution – A CRA recognized within the EU for regulatory purposes, particularly under the Capital Requirements Directive (CRR)
ERP	European Ratings Platform, ESMAs database of public credit ratings issued or endorsed by CRAs covered by ER CRAR
RADAT	The internal FCA supervisory database for credit ratings data. For the publicly available database please see PRD
PRD	The FCA's online Public Ratings Database
ESAP	European Single Access Point. A data hub proposed by the EU to access credit rating and other financial information about EU companies and EU investment products.
ESMA	The European Securities and Markets Authority
EU CRAR	The version of CRAR which applies in the European Union
FCA	Financial Conduct Authority
IOSCO	International Organization of Securities Commissions
MDV	Market Data Vendor – a commercial supplier and distributor of data relating to financial markets
MIR	Market Implied Rating
MTF	Multilateral Trading Facility
NRSROs	Nationally Recognized Statistical Ratings Organisation – A CRA which is registered and approved by the SEC
OTF	Organised Trading Facility
PRD	Public Ratings Database, the FCAs database of public credit ratings issued or endorsed by CRAs covered by UK CRAR
PRA	The UK's Prudential Regulation Authority
UK CRAR	The version of CRAR which applies in the United Kingdom

CRR firms	UK banks, building societies, or investment firms subject to the Capital Requirements Regulation.

Financial Conduct Authority