

Credit rating agencies

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The Committee on Economic and Monetary Affairs adopted the report drawn up by Jean-Paul GAUZES (EPP-ED, FR) amending, under the first reading of the codecision procedure, the proposal for a regulation of the European Parliament and of the Council on Credit Rating Agencies.

The main amendments are as follows:

Subject matter: MEPs point out that the regulation introduces measures to ensure the integrity, transparency, responsibility, good governance and institutional cooperation of credit rating activities resulting in credit ratings of high quality to be used in, or having an impact in the Community.

Rating of entities or products that are located in a third country: the rating of entities or products that are located in a third country, may be used within the Community where: (a) those ratings are endorsed by a credit rating agency that is established in the Community and registered in accordance with this Regulation; et (b) the third-country credit rating activities resulting in the issuance of the credit rating to be endorsed are subject to a legal and supervisory framework deemed to be equivalent to the measures provided for in this Regulation. To this end, the Commission shall establish and publish a list of third-country legislation deemed to be equivalent to this Regulation.

A credit rating agency that has endorsed a credit rating prepared or issued by a third-country credit rating agency shall remain fully responsible for that credit rating and for the fulfilment of the conditions of that endorsement.

Independence and avoidance of conflicts of interest: a credit rating agency shall disclose the nature of its compensation arrangements as regards rated entities. It shall separate, legally and operationally, its credit rating business from its ancillary services. credit rating agency shall appoint a person responsible for the compliance of the credit rating agency and its employees with this Regulation.

According to MEPs, criteria should be provided for to exempt credit agencies with a small number of employees from certain requirements of the proposed Regulation. In this context, the CESR may, upon the request of the credit rating agency, exempt a credit rating agency from the requirements referred to in the Regulation if the agency employs fewer than 25 analysts.

Analysts and other employees: with a view to avoiding conflicts of interest, a credit rating agency shall ensure that analysts that are in direct contact with issuers shall be involved in providing the credit rating services to the same rated entity, to its related third parties or to entities under common ownership, for a period not exceeding **five years**. Any **rotation** of analysts shall be undertaken in phases on the basis of individual rating analysts rather than a complete team.

Rating methodologies: credit rating agencies shall make available on a dedicated page of their websites, free of charge and accessible at any time, information on structured finance products, which explains assumptions, parameters, limits and uncertainties surrounding their models and rating methodologies, including simulations of stress scenarios undertaken by the agency when establishing the ratings. That information shall be clear and easily comprehensible.

Credit rating agencies shall also: (i) take adequate steps to assess the credibility, robustness and accuracy of data and information provided to them by issuers or related parties (e.g. originators, underwriter or lawyers, in the case of structured finance products); (ii) indicate to which extent they have verified

information provided to them; (iii) adopt procedures and mechanisms to protect the confidential nature of information it obtains from issuers; (iv) issue a warning in the event of general adverse and extreme market conditions.

A credit rating agency needs to be able to explain ex post their methodology, models and key assumptions to competent authorities.

Disclosure and presentation of credit ratings: a credit rating agency shall disclose, on ongoing basis, information about all structured finance products submitted for their initial review or a preliminary rating. Such disclosure shall be made whether or not issuers contract with the credit rating agency for a final rating.

In order to increase transparency and protection for investors, a credit rating agency shall document and disclose all the steps, information and factors which have given rise to a rating. Moreover, an amendment stresses that separate rating categories shall be used for structured, complex instruments.

Transparency of information: issuers providing information to a registered credit rating agency, for the purpose of establishing a rating, shall provide the same information, on request, to any bona fide analysis service. Such an analysis service shall undertake to respect confidentiality in the use of that information. Employees of such an analysis service shall also undertake not to trade in securities issued by the issuer concerned.

Registration: according to MEPs, the Committee of European Securities Regulators (CESR) should become the only registration and supervisory body over European rating agencies. CESR, and not national authorities as originally proposed, would be in charge of registering CRAs, checking their compliance with the rules and ultimately withdrawing an agency's registration should the rules be breached. CESR would inform Member State authorities once all registration steps are accomplished.

Moreover, the CESR should monitor the past performances of credit rating agencies on the basis of statistical results. It shall subsequently publish statistics on credit rating agencies and their performances, inter alia as regards the reliability of their ratings.

Reform of the CESR: MEPs believe it is appropriate to carry out a reform of the CESR, either by expanding the CESR itself into an independent European agency, or by establishing a centralised European agency which issues credit ratings. An amendment stipulates that by 12 months after the entry into force of this Regulation, the CESR shall submit a business plan detailing how a European agency should be operated.

Non-profit-making organisation: MEPs call for a new, independent non-profit-making organisation to be established to issue credit ratings. That organisation shall have a start-up capital of EUR 200 million, which shall be provided, on a pro rata basis, from the budget of the European Union, the European finance industry and by rated entities. The organisation shall receive additional, current revenue in the form of charges for issued ratings to be paid by the customer or the applicant. The organisation shall operate in such a way as to cover its costs. The Commission shall put forward a corresponding proposal.

Powers of competent authorities: credit rating agencies should perform their rating task without interference from supervisory bodies or the government. This also includes methodologies.

Complaints: the CESR shall ensure that procedures are set up which allow issuers, investors and other interested parties to register complaints about the fulfilment of the requirements and conditions laid down in this Regulation. Member States shall encourage the setting-up of appropriate and effective complaints

procedures for the out-of-court settlement of disputes between credit rating agencies and issuers, investors and other interested parties where appropriate about the fulfilment of the requirements and conditions laid down in this Regulation.

Penalties: the CESR should work towards convergence in the rules applicable to infringements of the provisions of this Regulation so as to avoid arbitrage. The Commission shall develop a comparable liability scheme for credit rating agencies and auditors.

Commission report: as soon as possible, and in any event by 1 July 2010, the Commission shall present to the European Parliament, the Council and other institutions concerned, a report on further reform of the supervisory regime under this Regulation and, in accordance with the applicable procedure under the Treaty, any appropriate legislative proposal.