

# Credit rating agencies

2008/0217(COD) - 23/04/2009 - Text adopted by Parliament, 1st reading/single reading

The European Parliament adopted by 569 votes to 47, with 4 abstentions, a legislative resolution modifying, 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 amendments are the result of a compromise negotiated with the Council. The main amendments are as follows:

**Subject matter:** the compromise points out that the regulation introduces a common regulatory approach to enhance the integrity, transparency, responsibility, good governance and reliability of credit rating activities, contributing to the quality of credit ratings issued in the Community.

**Scope:** it is clarified that the regulation applies to credit ratings issued by credit rating agencies registered in the Community and which are disclosed publicly or distributed by subscription.

The regulation does not apply to: (a) private credit ratings produced on an individual order and provided exclusively to the person that ordered them and which are not intended for public disclosure or distribution by subscription; (b) credit scores, credit scoring systems or similar assessments related to obligations arising from consumer, commercial or industrial relationships; (c) credit ratings produced by export credit agencies as described in Directive 2006/48/EC; (d) credit ratings produced by the central banks and which are issued in accordance with the principles, standards and procedures which ensure the adequate integrity and independence of credit rating activities as provided for by the regulation.

A credit rating agency shall apply for registration under the regulation as a condition for being recognised as the External Credit Assessment Institution (ECAI) as regulated in Directive 2006/48/EC, unless it only issues certain credit ratings.

**Use of credit ratings:** the prospectus published under Directive 2003/71/EC and Commission Regulation No 809/2004/EC should contain clear and prominent information stating whether or not the credit ratings concerned are issued by a credit rating agency established in the Community and registered under the regulation.

Credit rating agencies established in the Community and registered in accordance with this Regulation may endorse a credit rating, issued in third countries only when credit rating activities resulting in the issuance of such a credit rating comply with certain conditions. In particular, the credit rating agency must have verified and be able to demonstrate on an ongoing basis to its competent authority that the conduct of credit rating activities by the third country credit rating agency resulting in the issuance of the credit rating to be endorsed fulfils the requirements which are at least as stringent as the requirements set out in the regulation.

**Equivalence and certification based on equivalence:** the credit ratings related to entities established or financial instruments issued in third countries issued by a credit rating agency which is established in a third country may be used in the Community without being endorsed, provided that: (a) the credit rating agency is authorised or registered and is subject to supervision in that third country; (b) the Commission has adopted an equivalence decision, recognising the legal and supervisory framework of a third country as equivalent to the requirements of the regulation.

As regards smaller credit rating agencies from third countries with no presence or affiliation in the Community, a specific regime of certification should be made available, provided they are not systemically important for the financial stability or integrity of the financial markets of one or more Member States. The equivalence mechanism envisaged should offer the possibility for qualifying credit rating agencies from a third country to be assessed on a case-by-case basis and be granted an exemption from some of the organisational requirements for credit rating agencies active in the Community, including the requirement of physical presence in the Community.

**Independence and avoidance of conflicts of interest:** a credit rating agency shall take all necessary steps to ensure that the issuance of a credit rating is not affected by any existing or potential conflict of interest or business relationship involving the credit rating agency issuing the credit rating, its managers, rating analysts, employees or any other natural person whose services are placed at the disposal or under the control of the credit rating agency or any person directly or indirectly linked to it by control.

Upon request of a credit rating agency, the competent authority of the home Member State may exempt a credit rating agency from complying with certain requirements if the credit rating agency is able to demonstrate that in view of the nature, scale and complexity of its business, and the nature and range of issuance of credit ratings, the requirements are not proportionate and that: (a) the credit rating agency has fewer than 50 employees; (b) the credit rating agency has implemented measures and procedures, in particular internal control system, reporting arrangements and measures ensuring independence of analysts and persons approving credit ratings, which ensure the effective compliance with the regulatory objectives set out in the regulation.

**Rating analysts, employees and other persons involved in the issuance of credit ratings:** under the compromise, a credit rating agency shall establish an appropriate gradual rotation mechanism with regard to the rating analysts and persons approving credit ratings. That rotation mechanism shall be undertaken in phases on the basis of individuals rather than of a complete team. Compensation and performance evaluation of rating analysts and persons approving the credit ratings shall not be contingent on the amount of revenue that the credit rating agency derives from the rated entities or related third parties.

In order to avoid conflicts of interest, the lead rating analysts shall not be involved in credit rating activities related to the same rated entity or its related third parties for a period exceeding four years. For rating analysts, that period should not exceed five years. The persons approving credit ratings shall not be involved in credit rating activities related to the same rated entity or its related third parties for a period exceeding seven years.

**Methodologies:** a credit rating agency shall use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing. A credit rating agency shall monitor credit ratings and review its credit ratings and methodologies on an ongoing basis and at least annually, in particular where material changes occur that could have an impact on a credit rating.

**Outsourcing:** a new article stipulates that outsourcing of important operational functions shall not be undertaken in such a way as to impair materially the quality of the credit rating agency's internal control and the ability of the competent authorities to supervise the credit rating agency's compliance with obligations under the regulation.

**Disclosure and presentation of credit ratings:** a credit rating agency shall disclose any credit rating, as well as any decisions to discontinue a credit rating on a non-selective basis and in a timely manner. In the event of a decision to discontinue a credit rating, the information disclosed shall include the reasons for such a decision.

A credit rating agency shall ensure that rating categories that are attributed to structured finance instruments are clearly differentiated using an additional symbol which distinguishes them from rating categories used for any other entities, financial instruments or financial obligations.

A credit rating agency shall ensure that it does not use the name of any competent authority in such a way that would indicate or suggest endorsement or approval by that authority of the credit ratings or any credit rating activities of the credit rating agency.

Credit rating agencies shall make available in a central repository established by the CESR information on their historical performance data including the ratings transition frequency and information about credit ratings issued in the past and on their changes. The CESR shall make that information accessible to the public and shall publish summary information on the main developments observed on an annual basis.

**Requirement for registration:** a credit rating agency shall apply for registration provided that it is a legal person established in the Community. The registration shall be effective for the entire territory of the Community once the registration decision issued by the competent authority of the home Member State has taken effect under the relevant national law.

**Application for registration:** credit rating agencies shall submit their application in the language which is required under the law of their respective home Member States and also in a language customary in the sphere of international finance. Applications received by competent authorities of the home Member States from CESR shall be considered to be applications submitted by credit rating agencies.

Within ten working days of receipt of the application, CESR shall provide advice to the competent authority of the home Member State on the completeness of the application.

The facilitator shall coordinate the examination of the application submitted by the credit rating agency and shall ensure that all information necessary to carry out the examination of the application is shared among the members of the college. In the event of a continued absence of agreement among the members of the college, the competent authority of the home Member State shall adopt a fully reasoned refusal decision, which shall identify the dissenting competent authorities and shall include a description of their views.

**Committee of European Securities Regulators (CESR):** within nine months after the entry into force of the regulation, CESR shall issue guidance relating to: (a) enforcement practices and activities to be conducted by competent authorities under the regulation; (b) common standards for assessment of compliance of credit rating methodologies with the requirements set out in the regulation; (c) types of measures to ensure that credit rating agencies continue to comply with legal requirements; (d) information that the credit rating agency should provide for the application for certification and for the assessment of systemic importance to the financial stability or integrity of financial markets.

**Powers of competent authorities:** in carrying out their duties under the regulation, neither the competent authorities of Member States nor any other public authorities of the Member States shall interfere with the content of credit ratings or the methodologies.

**Exchange of information:** competent authorities shall without undue delay supply one another with the information required for the purposes of carrying out their duties under the regulation. They may transmit to the competent authorities responsible for supervision of institutions, central banks, the European System of Central Banks and the European Central Bank, in their capacity as monetary authorities, and, where appropriate, to other public authorities responsible for overseeing payment and settlement systems, confidential information intended for the performance of their tasks. Similarly, such authorities or bodies shall not be prevented from communicating to the competent authorities such information as they may need for the purpose of performing their functions provided for in the regulation.

**College of competent authorities:** this should represent the effective platform for an exchange of supervisory information among competent authorities, coordination of their activities and supervisory measures necessary for effective supervision of credit rating agencies. In particular, the college of competent authorities should facilitate the monitoring of the fulfilment of conditions for endorsement of credit ratings issued in third countries, certification, outsourcing arrangements, and the exemption for a credit rating agency referred to in the regulation. The activities of the colleges of competent authorities should contribute to harmonised application of rules under the regulation and to convergence of supervisory practices.

In order to enhance practical coordination of activities of the college the members of the college should select among themselves a facilitator. The facilitator should chair the meetings of the college, establish written coordination arrangements for the college and coordinate the actions of the college. During the registration process the facilitator should assess the need to extend the period for examination of an application, coordinate examination of an application and liaise with CESR.

**Disclosure of information from another Member State:** the competent authority of a Member State may only disclose the information received from a competent authority of another Member State if the competent authority of the Member State concerned has obtained express agreement of the competent authority which has transmitted the information and, where applicable, the information is disclosed solely for the purposes for which that competent authority gave its agreement without prejudice to the need for disclosure in relation to legal proceedings.

**Penalties:** penalties should be effective, proportionate and dissuasive. The competent authority shall disclose to the public every penalty that has been imposed for infringement of the provisions adopted in the implementation of the regulation, unless such disclosure would seriously jeopardise the financial markets or cause disproportionate damage to the parties involved.

**Reports:** by three years after entry into force of the regulation, the Commission shall make an assessment of the application of the regulation, including an assessment of the impact on the level of concentration in the credit rating market, the cost and benefit of impacts of the regulation and of the appropriateness of the remuneration of the credit rating agency by the rated entity, and submit a report to the European Parliament and the Council of the European Union.

By one year after entry into force of the regulation, the Commission shall make an assessment of the application of Title III of the regulation, in particular of the cooperation of supervisory authorities, of the legal status of the CESR and of the supervisory practices under the terms of the regulation and present a report to the European Parliament and to the Council, accompanied, where appropriate, by proposals for its review.

In the light of developments in the regulatory and supervisory framework for credit rating agencies in third countries, the Commission shall present a report to the European Parliament and to the Council concerning the effects of those developments and of transitional provision referred to in the regulation on stability of financial markets in the Community.

**Transitional provision:** existing credit rating agencies which intend to apply for registration under the regulation shall adopt all necessary measures to comply with its provisions by a certain deadline. Existing credit rating agencies shall, in any event, submit their application for registration by nine months after entry into force of the regulation.

**Entry into force:** the regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union. Member States shall have six months to take the necessary measures to implement its provisions. As an exception, for the provisions on the use of credit ratings

issued by agencies outside of the Community, the regulation shall apply from eighteen months after its entry into force.