

Credit rating agencies: supervision

2010/0160(COD) - 02/06/2010 - Legislative proposal

PURPOSE: to improve the supervision carried out by credit rating agencies.

PROPOSED ACT: Regulation of the European Parliament and of the Council.

BACKGROUND: experience of the financial crisis has exposed important failures in financial supervision, both in particular cases and in relation to the financial system as a whole. Building on the findings of the group of high level experts, chaired by Mr Jacques de Larosière, the European Commission has piloted a fundamental overhaul of financial supervision in Europe with the objective of establishing a more efficient, integrated and sustainable European system of supervision.

The Group presented its report on 25 February 2009 and its recommendations were endorsed by the Commission in its [Communication](#) to the Spring European Council of March 2009. The key elements of the reform proposed by the Commission are :

- the establishment of a European System of Financial Supervisors (ESFS), consisting of a network of national financial supervisors working in tandem with new European Supervisory Authorities (ESAs), created by transforming the existing European supervisory committees in a European Banking Authority ([EBA](#)), a European Insurance and Occupational Pensions Authority ([EIOPA](#)), and a European Securities and Markets Authority ([ESMA](#)), and
- the establishment of a European Systemic Risk Board ([ESRB](#)), which shall monitor and assess potential threats to financial stability that arise from macro-economic developments and from developments within the financial system as a whole.

In its [Communication](#) of 27 May 2009, the Commission proposed that a European Supervisory Authority should be given the responsibility for the authorisation and supervision of certain entities with pan-European reach, e.g., credit rating agencies. These responsibilities would be defined in the Regulation (EC) No 1060/2009 on Credit Rating Agencies of the European Parliament and of the Council ([Credit rating Agencies Regulation](#)).

The Commission's suggestion was endorsed by the European Council, at its meeting in June 2009, stating clearly that ESMA should also have supervisory powers for credit rating agencies. The European Parliament and the Council requested the Commission to put forward, by 1 July 2010, a report and any legislative proposal needed to tackle the shortcomings identified as regards supervisory coordination and cooperation arrangements.

IMPACT ASSESSMENT: the Commission analysed several options:

Option 1: status quo: the key elements of the current supervisory set-up, agreed in the course of the negotiation of the CRA Regulation, would be maintained;

Option 2: college structure and ESMA: the ESMA Regulation is adopted as proposed by the Commission on 23 September 2009 and that the supervisory framework as provided by the current CRA Regulation is maintained;

Option 3 - ESMA to assume direct oversight of groups of CRAs or all EU-based CRAs: the CRA Regulation would be revised in order to introduce centralised oversight of credit rating agencies operating in the EU.

- *Option 3a:* ESMA's authority would be limited to the supervision of CRAs (groups of CRAs) with legal presence in more than one Member State.
- *Option 3b:* ESMA would be the sole supervisor of all EU-based CRAs.

The European Commission therefore considers that it is appropriate **to present a proposal amending the Regulation on credit rating agencies.**

LEGAL BASE: Article 114 of the TFEU. Community action can address the weaknesses highlighted by the crisis and provide a system that is in line with the objective of a stable and single EU financial market for financial services.

CONTENT: this proposal seeks to amend Regulation (EC) No 1060/2009 on Credit Rating Agencies which is to be revised in order to introduce centralised oversight of credit rating agencies operating in the EU. ESMA is to assume general competence in matters relating to the registration and on-going supervision of registered credit rating agencies as well as matters related to ratings issued by rating agencies established in third countries that operate in the EU under the certification or endorsement regimes.

This proposal does not introduce any changes to the Regulation on credit rating agencies concerning the substantive conditions that CRAs have to fulfil in order to be registered and later on an ongoing basis. Similarly, the conditions under which ratings issued from credit rating agencies located in third countries may be used in the Union (via the endorsement and certification mechanisms, as foreseen in the CRA Regulation) are not subject of the proposed amendments but will remain as provided for in the current CRA Regulation.

The main amendments proposed are the following:

Subject matter, scope and definitions: in order to align the Regulation with the new proposal for a Directive on Alternative Investment Fund Managers, **alternative investment funds** have been listed in order to treat them in the same way as the other EU financial institutions with regard to the use of credit ratings. This implies that in case alternative investment funds use credit ratings for regulatory purposes, those credit ratings must have been issued by a credit rating agency registered or certified under this Regulation.

Issuing of Credit Ratings: in order to avoid possible conflicts of interest arising for the CRA under the issuer-pays model which are particularly virulent regarding the rating of structured finance instruments, to enhance transparency and to increase competition among CRAs, issuers of structured finance instruments or related third parties should be required to give **access to the information** which they have given to the CRA they hired for the purpose of rating structured finance instruments to competing CRAs.

Provided they satisfy certain organisational and confidentiality conditions, competing CRAs should be given access, upon request, by the rated entity or a related third party to the information given for the purposes of rating structured finance instruments to the CRAs it hires. The competing CRA being granted access to information should not use it for any other purposes than for the rating and should be required to provide a minimum number of unsolicited ratings, in order to ensure that the request for access to this information does not pursue other purposes.

Contrasting to the other substantive requirements in the CRA Regulation which are addressed to credit rating agencies and its staff, this rule imposes **disclosure requirements to issuers of structured finance instruments**. All registered credit rating agencies will have the possibility to access the information necessary for issuing unsolicited ratings of structured finance instruments. This will lead to more competition in the rating market and increase the number of ratings per instrument so that users of ratings will be able to rely on more than one rating for the same instrument.

Registration procedure: as a result of introduction of the new, single supervisory authority for the oversight of credit rating agencies, existing provisions, which envisage a college type of supervisory coordination and ultimate, formal decision-making by a competent authority of the home Member State, are to be eliminated. The creation of ESMA will improve and streamline the procedure for registration, making it simpler (as a result of eliminating redundant consultation steps between authorities in the college and with CESR) and thus it is possible to reduce the time limits in the different stages of the registration process.

Surveillance by ESMA: in order to facilitate day-to-day application of the Regulation, ESMA should be **empowered to propose draft technical standards** to be endorsed by the Commission on: i) the registration process, including on the information set out in Annex II; ii) the information that the credit rating agency must provide for the application for certification and for the assessment of its systemic importance to the financial stability or integrity of financial markets; and iii) the presentation of the information, including structure, format, method and period of reporting, that credit rating agencies shall disclose.

ESMA is to be empowered **to require all necessary information** from CRAs and other persons related to credit rating activity. It will be able to start investigations into the potential breaches of the Regulation and in the remit of those it must be able to exercise supervisory powers such as examining records and other relevant material and taking copies/extracts thereof, requiring oral explanations, hearing a person, requiring records of telephone and data traffic.

The ESMA must also be able to conduct **on-site inspections**. The rights of defence of the persons concerned shall be fully respected in the proceedings. In particular, ESMA must give the persons concerned the opportunity of being heard on the matters to which ESMA has taken objection.

Cooperation between ESMA and competent authorities: competent authorities are to keep the oversight responsibilities regarding the use of credit ratings by the supervised entities (like credit institutions, or insurance undertakings) which employ those credit ratings for regulatory purposes. National supervisory authorities must also contribute to the supervisory activity of ESMA, by ensuring all necessary information exchange and co-operation, which may be required in the exercise of supervisory and enforcement powers of ESMA.

Where necessary or appropriate for reasons of efficiency, in its supervisory activity ESMA must be able to **seek the assistance** of a competent supervisory authority at national level. Assistance by competent authorities should be provided when ESMA is carrying out investigations and on site inspections.

ESMA may also **delegate specific supervisory tasks** to competent national authorities. Possible tasks that may be delegated include the carrying out of specific investigatory tasks and on-site inspections, the assessment of an application for registration, but also tasks related to day-to-day supervision. Delegation of tasks will not affect the responsibility of ESMA which may give instructions to the authority to which it has delegated a task.

Penalties, Committee procedure and reporting: ESMA may propose to the Commission to impose **periodic penalty payments**. This coercive measure is to help achieve that: i) an infringement is put to an end, ii) complete and correct information which ESMA has requested is supplied; iii) credit rating agencies and other persons submit to an investigation. ESMA may also propose **finances** to be adopted by the Commission, where, intentionally or negligently, some of the provisions of the Regulation on credit rating agencies have been breached. Detailed criteria for establishing the amount of the fines as well as procedural aspects related to fines will be set out in a delegated act.

In addition to proposing sanctions, ESMA shall also be empowered to adopt supervisory measures where a credit rating agency has committed a breach of the Regulation. Those measures include the **temporary prohibition** of the issuing of credit ratings and the **suspension of the use of the credit ratings** concerned until the infringement has been put to an end. As a last resort measure, ESMA is empowered to withdraw the registration of a credit rating agency.

In addition, ESMA has the power to require the credit ratings agencies to bring an infringement to an end and to issue public notices. Those measures shall be applied in cases which do not justify the adoption of a sanction or more severe supervisory measure, taking account of the principle of proportionality.

The committee procedures have been aligned with the Lisbon Treaty.

Transitional and final provisions: once ESMA will be in place and operational, the competent authorities of the Member States will have to terminate their competences and duties related to the supervisory and enforcement activity in the field of credit rating agencies which had been conferred to them by the Regulation on credit rating agencies.

BUDGETARY IMPACT: an overall overview of the budgetary implications of the proposals setting up ESMA was presented in September 2009 in the impact assessment report and accompanying legislative financial statements accompanying such legislative proposals (*see the legislative financial statement added to the proposal on the setting up of the European Securities Markets Authority*).

The specific implications on ESMA concerning the direct supervision and oversight of credit rating agencies are specified in the legislative financial statements accompanying this proposal. The impact for the 2011-2013 are the following:

- Operating appropriations: EUR1.001 million
- Human resources and other administrative expenditure: EUR 1.464 million
- Total appropriations: **EUR 2.465 million.**

The proposal provides for co-funding estimated at EUR 1.501 million in 2011 (60% of total needs by Member States, via EU National Supervisors –proposed ESMA standard financing mechanism).