

Institutions for occupational retirement provision, undertakings of collective investment in transferable securities (UCITS) and Alternative Investment Funds Managers: risk management

2011/0360(COD) - 02/04/2012

OPINION OF THE EUROPEAN CENTRAL BANK on a [proposal for a regulation](#) amending Regulation (EC) No 1060/2009 on credit rating agencies and a proposal for a directive amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings of collective investment in transferable securities (UCITS) and Directive 2011/61/EU on alternative investment funds managers in respect of the excessive reliance on credit ratings.

The ECB shares the general objective pursued under the proposed regulation and the proposed directive which is to contribute to reducing financial stability risks and restoring the confidence of investors and market participants in financial markets and ratings quality.

The ECB shares the Commission's specific objective of reducing excessive reliance on external credit ratings, which is in line with the principles established by the Financial Stability Board (FSB) in this field.

The ECB also supports the comprehensive powers entrusted to the European Securities and Markets Authority (ESMA) relating to authorisation and supervision of credit rating agencies (CRAs).

The ECB makes the following observations:

1. Excessive reliance on external credit ratings

- ***Credit risk assessment by financial institutions*** : the ECB supports the FSB's and the Commission's common objective of reducing overreliance on external credit ratings.

More specifically, the ECB notes that the proposal for a directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC ([proposed CRD IV Directive](#)) includes provisions addressing this issue.

The ECB also notes the corresponding amendments introduced in Directive 2009/65/EC and Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

Therefore, in order to ensure consistency between the proposed regulation and corresponding provisions in the sectoral legislation, the ECB recommends clarifying the nature of the obligation imposed on financial institutions in the proposed regulation.

- ***References to external ratings in Union legislation*** : the ECB understands that all the proposed amendments are aimed at implementing the FSB principles, which invite 'standard setters and authorities

to assess references to CRA ratings in standards, laws and regulations and, wherever possible, **remove them or replace them** by suitable alternative standards of creditworthiness'. However, while it might be advisable to remove provisions imposing compulsory recourse to external ratings from Union and national legislation or even all references to external ratings to the extent that these requirements or references to external ratings might be perceived as encouraging 'mechanistic' recourse to such ratings, the ECB would recommend caution regarding the drafting proposed in the above provisions of the proposed regulation, as this could prove difficult to apply.

The ECB supports the gradual approach advocated by the FSB and notes that references to CRAs' ratings should be removed or replaced only once credible alternatives have been identified and can safely be implemented.

In this context, it is necessary that standard setters and authorities develop transition plans and timetables to enable the removal or replacement of references to CRAs' ratings wherever possible and the associated enhancement in risk management capabilities to be safely introduced.

The ECB recommends replacing Article 1(6) of the proposed regulation by a recital in the proposed regulation that reminds public authorities of the importance of contributing where appropriate to the abovementioned objective of reducing excessive reliance on external credit ratings. Moreover, the ECB recommends that the ESAs, after having taken account of the contributions of the ECB and of the ESRB, **report to the Commission on possible alternative or complementary solutions with regard to references to external ratings** in Union and national legislation.

2. Credit rating agencies and external credit assessment institutions (ECAIs)

- ***External credit assessments and eligibility of ECAIs*** : under the proposed CRD IV regulation, the procedure of ECAI recognition by competent authorities results in 'automatic' eligibility of CRAs that are registered or certified in accordance with Regulation (EC) No 1060/2009. This also applies to central banks issuing credit ratings which are exempt from that Regulation.

The ECB supports the new procedure contained in the proposed CRD IV regulation, as it will contribute to simplifying the recognition procedure for ECAIs and ensuring cross-sectoral consistency. For the sake of legal clarity and transparency, the ECB would however suggest further clarifying in a recital of the proposed regulation that the entry into force of the proposed CRD IV regulation will imply an automatic recognition of the above CRAs and central banks (as ECAIs) and that there is a need to define the correspondence between credit assessments and credit quality steps, i.e. mapping.

- ***Mapping and European rating index*** : whilst the ECB supports enhanced transparency, interoperability and comparability of ratings by market participants, it should however be ensured, in view of the possible negative effects on competition and on the diversity of rating methods, that a harmonised rating scale does not exert pressure on CRAs to harmonise methodologies and processes.

Moreover, the ECB notes that mapping procedures will be developed by EBA and EIOPA in the banking and in the insurance sectors. In view of the cross-sectoral nature of these issues, it would be appropriate to coordinate the mapping exercises, possibly through the Joint Committee of the ESAs. In this context, the ECB recommends deleting the reference to the harmonised rating scale and suggests that, by December 2015, ESMA, in cooperation with EBA, EIOPA and the ECB, reviews the feasibility of establishing a harmonised rating scale for ratings issued by registered and certified CRAs and reports to the Commission on this issue.

3. Other observations

- **Sovereign ratings** : the ECB supports the initiatives taken to enhance transparency and disclosure of the methodology and rating process in relation to sovereign debt. The proposed regulation introduces a special regime as regards the frequency of review and the procedure for the issuance of sovereign ratings. The ECB welcomes these proposed changes and notably the proposal to request CRAs to assess sovereign ratings more frequently. While ratings should only be published after the close of business and at least one hour before the opening of trading venues in the Union, the ECB considers that other initiatives could be taken to alleviate the potential pro-cyclical effects of changes in ratings.

The ECB recommends exploring ways of reducing the volatility induced by the timing of the rating changes, notably when an issuer is on ratings watch and is close to losing its investment grade status as well as when a potential downgrade of several notches is being contemplated.

- **Independence of CRAs** : since the current ‘issuer-pays’ financing model of ratings could be a source of conflict of interest and thus may have a distorting influence on ratings, more far-reaching solutions on alternative compensation models are warranted. The ECB welcomes therefore the Commission’s continued work on monitoring the appropriateness of CRAs’ remuneration models and looks forward to the submission of a report thereon to the European Parliament and the Council by the end of 2012. While the ECB supports the proposals for stricter rules as regards **shareholder structure** of CRAs, the ECB recommends that the Commission reviews the proposed threshold of 5 % in order to ensure its effectiveness.

- **Rotation principles** : while the ECB supports the Commission’s intention relating to the introduction of a rotation rule, i.e. that long-lasting relationships with the same rated entities could compromise the independence of ratings, possible unintended consequences may need to be further assessed.

- **Methodologies** : the ECB supports the proposed tasks conferred upon ESMA with regard to the compliance of new or amended CRAs methodologies. The ECB recommends clarifying that ESMA’s role is limited to verifying compliance of the methodologies with the applicable rules.

- **Rules on structured finance instruments** : with a view to ensuring cross-sectoral consistency and avoiding duplication of rules, the relationship between the disclosure requirements for issuers, originators and sponsors of structured finance products in the proposed regulation and similar disclosure requirements for securitisations in specific sectors should be clarified.

Second, the Eurosystem asset-backed securities (ABSs) loan-level information initiative establishes specific loan-by-loan information requirements for ABSs accepted as collateral in Eurosystem credit operations. It aims to increase transparency and make available more timely information on the underlying loans and their performance to market participants in a standardised format.

Lastly, the ECB welcomes initiatives contributing to the enhancement of transparency requirements in the structured finance instruments and covered bonds markets and the harmonisation of disclosure requirements in this area. It notes that initiatives related to the transparency of the covered bonds market are considered in other ongoing legislative initiatives, for instance in the proposed CRD IV regulation. Therefore, it is important to ensure the consistency of these various initiatives.