# Credit rating agencies: integrity, transparency, responsibility, good governance and independence of activities

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The Committee on Economic and Monetary Affairs adopted the report by Leonardo DOMENICI (S&D, IT) on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) No 1060/2009 on credit rating agencies.

The committee recommends that the position of the European Parliament adopted in first reading following the ordinary legislative proposal should amend the Commission's proposal as follows:

**Aim of the Regulation**: Members stress that the common regulatory approach should enhance the **independence** of credit rating activities.

The Regulation should apply to ratings concerning Member States and their **sovereign debt**.

**"Credit rating"**: this means an **information service** provided to investors and consumers, issued using an established and defined ranking system of rating categories and subject to a liability regime.

**Over-reliance on credit ratings by financial institutions**: competent authorities in charge of supervising these undertakings shall:

- **closely monitor** the adequacy of undertakings' credit assessment processes, taking into account the nature, scale and complexity of those undertakings' activities;
- ensure that they agree neither to **contractual rules that result in the automatic sale of assets in the event of a downgrade of the creditworthiness by an external credit rating agency**, nor to a rule requiring the use of a specific credit rating agency.

**Over-reliance on credit ratings in Union law**: Members consider that Union law **shall not refer to credit ratings for regulatory purposes**. They require that all provisions contained in sectoral legislation that provide for an obligation to take into account external ratings before investing or advising others to invest shall be repealed.

One year after entry into force of the regulation, the Commission shall present a detailed report containing **recommendations on the development of own rating capacities** so as to avoid automatic pro-cyclical reactions to changes in ratings. ESMA shall also provide recommendations on the development of own rating capacities so as to avoid automatic pro-cyclical reactions to changes in ratings.

**Due diligence obligations and internal risk management:** the report notes that overreliance on external credit ratings occurs when financial institutions and institutional investors rely solely on ratings issued by credit rating agencies while neglecting their own due diligence and internal risk management obligations.

Members want to **reinforce the financial institutions' and institutional investors' due diligence obligations** and internal risk management obligations when acquiring financial products, especially complex or structured products.

Financial regulation should also increase the disclosure obligations for issuers of financial products, **especially for highly complex or structured products**.

When investors disregard intentionally or with gross negligence their due diligence and their internal risk management obligations, **credit rating agencies shall not be held liable** for damage or loss arising from such conduct.

**Independence of ratings and conflict of interest:** credit rating agencies should establish, an **effective internal control structure** governing the implementation of policies and procedures to the prevention and control of possible conflicts of interest and to ensure the independence of ratings, analysts and rating teams regarding shareholders, administrative and management bodies and sales and marketing activities.

The amendments aim to ensure: (i) **prohibition of cross-shareholding** where the management or control of more than one rating agency is concerned; (ii) prohibition on rating agencies holding shares, or have financial interests, in rated entities; (iii) **restrictions on the merger and acquisition activity** of rating agencies which have already generated more than 20 % of the total annual revenues for credit rating activities in the Union.

An amendment stipulates that a shareholder or a member of a credit rating agency holding at least 5% of the capital or the voting rights in that agency shall not be shareholder or member of another credit rating agency or otherwise have a direct or indirect ownership interest in such other credit rating agency.

**Ensuring competition in the market for credit ratings**: the Commission shall report annually on **competition in the market for credit ratings**, and shall publish figures on the percentage of the total market held by registered credit rating agencies, measured by revenue.

**Risks taken into consideration**: a credit rating agency shall adopt adequate measures to ensure that the credit ratings and the rating outlooks it issues are based on a thorough analysis of all the information concerning all types of financial risks, including environmental risks.

**Sovereign debt ratings**: Members state that sovereign debt ratings shall be issued in a manner which ensures that the individual specificity of a particular Member State has been analysed. **A statement announcing revision of a given group of countries shall be prohibited even if accompanied by individual country reports.**

**Mandatory use of small agencies**: where an issuer or a related third party intends to mandate at least two credit rating agencies for the credit rating of the same issuance or entity, the market share in the Union of **at least one of the credit rating agencies shall be below a threshold set by ESMA.** The latter shall set a threshold aiming to ensure the development of a market without oligopolistic tendencies.

**Publication of ratings**: a credit rating agency shall disclose any solicited credit rating or rating outlook, as well as any decision to discontinue a credit rating, on a non-selective basis and in a timely manner.

Until disclosure to the market of the information concerning the rating, the credit rating agency shall keep the information **confidential.**

**Evaluation of agencies by ESMA**: Members stipulate that ESMA shall analyse and assess the performances of credit rating agencies using the data collected on its central repository, and publish an **annual report** on its comparative assessment, including a rating system of the performance.

ESMA shall also ensure that a **certain variety of methodologies** is maintained in order to encourage competition for the best methodologies between the rating agencies and to avoid standardisation of methodologies. If ESMA detects any deviation, the credit rating agency shall remove that deviation within one month.

**Penalties for rating agencies exceeding their remit:** where the European System of Financial Supervisors establishes that a rating agency has exceeded its remit by issuing a **judgment regarding the economic policies of a government** or recommendations in this respect it shall action, e.g. (i) a temporary ban of the issuing by the credit rating agency of credit ratings throughout the Union; (ii) imposition of a fine on the ratings agency; (iii) removal of credit rating agency from register.

**European creditworthiness assessment**: Members specify that the Union shall internally assess the creditworthiness of the Member States. To this end, an **independent public European creditworthiness internal assessment should be developed** to provide investors with all relevant data on ratings regarding sovereign debt and other key macroeconomic indicators publicly disclosed. That European creditworthiness assessment should be ensured through the existing Union institutions competent for this task.

**European credit ratings agency**: Members want the Commission to **examine the possibility of creating an independent European credit rating agency** or of establishing rules to allow European credit rating agencies to make an impartial and objective assessment of their creditworthiness. If necessary, the Commission should submit appropriate legislative proposals.

**Network of smaller ratings agencies**: the Commission shall put forward, by the end of 2012, a report regarding the feasibility of a network of smaller credit rating agencies in order to increase competition in the market. A small credit rating agency means a credit rating agency that has fewer than 50 employees or has an annual turnover of less than EUR 10 million, at group level.

**Report**: by 31 December 2013, the Commission shall, in light of developments in the regulatory and supervisory framework of the Union, present a report concerning the tools enabling investors and the wider public to make their own credit risk assessment of issuers, and assessing the feasibility of alternative payment models, accompanied, where appropriate, by proposals.