

**COMMISSION PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON  
CREDIT RATING AGENCIES**

**EuropeanIssuers' Comments**

**15 January 2009**

The European Commission published in November 2008 a proposal for a regulation, hereinafter the "Proposal", of the European Parliament and of the Council on credit rating agencies, hereinafter CRAs, which will be discussed by the Parliament between January and April 2009.

The regulation would apply to all ratings – solicited or not – used by the undertakings of the financial industry and would place the CRAs under the surveillance of (what we will call hereinafter) "securities commissions", which would be organised at European level. The measures set out in the Annexes of the Proposal, considered as non-essential elements, could be amended subsequently by the European Commission in accordance with a comitology procedure.

**COMMENTS**

**1) Execution of orders & reliance on credit ratings – Art. 4 par 2 should be deleted**

Art. 4 par 2 provides that "*investment firms and credit institutions should not execute orders on behalf of their clients with respect to financial instruments which have been rated, unless the credit rating has been issued by a credit rating agency registered in accordance with this Regulation*".

Issuers understand that this provision may be inspired by the legislator's concern that investment orders might be based on (unsolicited) ratings of poor quality by a CRA that is not subject to EU law and standards. However as it is written, it gives the impression that financial instruments without ratings are even preferable. We suppose that the intended meaning would correspond to "*investment firms and credit institutions should ~~not~~ execute orders on behalf of their clients with respect to financial instruments which have been rated, unless only if the credit rating has been issued by a credit rating agency registered in accordance with this Regulation*". Whatever the meaning of the provision however, we believe that this is too much interference with the domain of trading. As a matter of fact this provision is interfering directly with the provisions of MiFID. The proposed provision is all the more questionable because it goes against the general consensus, as expressed by many commentators of the financial crisis and subscribed by the legislator, that the reliance on credit ratings was (and probably still is) excessive. We are surprised that instead of coming forward with remedies against such excessive reliance, the proposed provision (and in fact

the very Proposal for that matter) seems to lay the foundations for even more reliance. We strongly believe that this provision should be deleted. Moreover the assessment of the reliance on ratings scheduled to take place “[three years after the entry into force of this Regulation]” according to Art. 34, should better be started immediately.

**2) The distinction between structured instruments and other financial (in particular traditional) instruments or entities should be enhanced – Art. 8**

For the rating of non structured financial instruments, we would recommend:

- the possibility of specific registration requirements for CRAs;
- in the credit rating categories that may be attributed, a clear and mandatory distinction between structured finance instruments and the other types of rated entities or financial instruments instead of making this alternative as under Art. 8,3 of the Proposal.

**3) CRAs should not be encouraged or allowed to control information further or to have information further controlled (beyond the controls performed by the issuer or the statutory audit) - Annexe I, section D, I, 3**

A CRA that is solicited by an issuer should use the information available or provided by the rated entity. Thus CRAs should not be required to publicly state in their credit ratings to what extent they have verified information provided to them by the rated entities, as provided for in the Annexe I, section D, I, 3. CRAs could indicate the main sources of information they have used and whether the information used has been verified as part of the statutory audit.

**4) The appropriateness of the remuneration of the solicited CRA by the rated entity (« issuer-pays model ») – Art. 34**

Art. 34 of the Proposal provides that the appropriateness of the “issuer-pays model” should in term be assessed. It should not be forgotten that this model relies on independence rules, controls performed by the CRAs and the competent authorities, as well as the disclosure of historical performance data.

On the other hand the remuneration by the investor, which already occurs, entails certain risks that should be taken into consideration:

- risks similar to those inherent in unsolicited credit ratings;
- lack of independence from, or conflicts of interest with the investor; (potential) investors may benefit from low/high or stable credit ratings;
- lack of public disclosure (although such disclosure is beneficial to other investors and to other stakeholders such as shareholders, suppliers,...);
- increased costs or lack of consistency arising from a multiplicity of credit ratings being published for the same instrument or issuer;
- difficulty to allocate costs between primary and secondary market investors.

### **5) Mandatory rotation - Art. 6, 4**

The principle of a rotation as under Art. 6, 4 of the proposal with regard to the analysts of the larger credit rating agencies seems appropriate, subject to preserving a good standard for analysts and for credit ratings (appropriate knowledge and experience for the duties assigned). However we caution against a mandatory rotation of the internal committee members approving credit ratings. Any such rotation could deprive the credit rating process of the experience needed to ensure the quality of credit ratings and their suitability for the business sector concerned. The larger credit rating agencies should rather be required to disclose the measures taken to ensure the objectivity of those persons in their relations with the rated entity.

### **6) Surveillance of credit rating activity by competent authorities - Chapter II**

- The European system should facilitate the access of new CRAs to the rating market and should not be more burdensome and costly for issuers than the systems of third countries. Therefore securities commissions should coordinate within IOSCO their registration decisions and their enforcement activities to monitor compliance with the IOSCO Code ("Code of Conduct Fundamentals for credit rating agencies"). That would meet the expectation of the Financial Stability Forum, which considers a consistent approach worldwide of critical importance;

- The Proposal does not specify how CESR assesses CRAs on a yearly basis or monitors compliance with the IOSCO Code. To avoid uneven application of the existing and future provisions at European level, CESR should coordinate the enforcement activities by the competent authorities concerned (rather than just issue guidance on those activities);

- The surveillance model proposed at European level seems generally acceptable (model where CESR assumes mediation, consultative and coordination functions). However some of the prerogatives of the competent authorities other than the competent authorities of the home Member States should be monitored by CESR more closely. In particular these competent authorities should not institute requests for withdrawal of registration and measures against a CRA without first obtaining an opinion of CESR. In case requests or measures depart from that opinion, the reasons should be explained (measures to ensure that the CRA complies with legal requirements, public notices when it breaches its obligations, criminal action).

### **7) Assumptions and risk warnings - Recital 17 and Annexe D, 2, c**

Under reference to Recital 17 and Annexe D, 2, c), we suggest clarifying that the assumptions and risk warnings indicated by the CRA are only meant to describe the working assumptions of the CRA and the sensitivity of the rating to its own assumptions (as opposed to the issuer's).

## **8) Confidentiality and use of information**

- To facilitate the access of new CRAs to the rating market and the continuity of the rating of issuers, a new CRA solicited by the issuer should be granted access to the rating documentation of the previously solicited agency, in case of change (either voluntary or following a withdrawal of registration, a temporary prohibition or the suspension of the use of credit ratings pronounced by a competent authority);

- In case of exchange of information between competent authorities, in particular competent authorities of third countries, the information exchanged should be intended only for the performance of the surveillance of CRAs (rather than the too broad « *intended for the performance of the tasks of those competent authorities* »). The authority that initially possesses information should be released from professional secrecy only in compliance with the relevant regimes that are applicable at the European level and in the Member States concerned.

## **9) Final comments**

The efficiency of the revised IOSCO Code of Conduct cannot be assessed yet, since it was only implemented since May 2008.

More regulation could not only lead to higher entrance-barriers for new candidate CRAs but also entail more responsibility for regulatory and surveillance bodies.

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