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POLICY DEPARTMENT A
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Credit Rating Agencies: Implementation of Legislation

STUDY for the ECON Committee

EN

2014

Credit Rating Agencies: Implementation of Legislation

EUROPEAN PARLIAMENT

DIRECTORATE GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

Proceedings of the Workshop on Credit Rating Agencies - Implementation of Legislation

Brussels, 18 March 2014

STUDY

Abstract

Upon request of the Committee on Monetary and Economic Affairs the Policy Department A organised a Workshop on Credit Rating Agencies - Implementation of Legislation. The objectives of the workshop have been twofold: Firstly, stock taking of the state of play regarding the implementation of the new regulation for Credit Rating Agencies in the European Union. Secondly, outlining potential further developments in this area. The Workshop took also into account global developments in the area of credit rating agencies regulation.

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DIRECTORATE GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

WORKSHOP

Credit Rating Agencies – Implementation of Legislation

- DRAFT Programme –

Tuesday, 18 March 2014, 12:30 – 15:00 hrs, European Parliament, Brussels

Room: **Altiero Spinelli 1G2**
Interpretation: DE/EN/FR/IT
Webstream: http://www.europarl.europa.eu/ep-live/en/committees/video?event=20140318-1230-COMMITTEE-ECON .

Chaired by Mr Leonardo DOMENICI, ECON Rapporteur for CRA III

12.30 - 12.40 hrs	**Welcome and Introduction by Mr Leonardo DOMENICI**
12.40 - 14.50 hrs	**Presentations and Discussion**
Participants	
Franco DESTRO	International Counsel, Securities and Exchange Commission (SEC) - International Organisation of Securities Commissions (**IOSCO**)
Grace SONE	Member of the Secretariat, Financial Stability Board (**FSB**), Basel, Switzerland
Felix FLINTERMAN	Head Credit Rating Agencies (CRA) Unit, European Securities and Markets Authority (**ESMA**), Paris, France
Dion BONGAERTS	Professor, Rotterdam School of Management, **Erasmus University**, Rotterdam, Netherlands • An Economic Analysis of Credit Rating Markets and Regulation
Gudula DEIPENBROCK	Professor, **Hochschule für Technik und Wirtschaft** (HTW), University of Applied Sciences, Berlin, Germany • After "CRA III" – Achievements and Challenges from the Legal Perspective
Ugo BASSI	Director, Directorate F - Capital and Companies, Directorate General Internal Market and Services (DG Markt), **European Commission**
14.50 - 15.00 hrs	**Closing remarks by Mr Leonardo DOMENICI**

1. AFTER 'CRA III – ACHIEVEMENTS AND CHALLENGES FROM THE LEGAL PERSPECTIVE

Gudula DEIPENBROCK, Berlin, Germany*

Abstract

This paper addresses selected legal issues and challenges of the European regulation of credit rating agencies in its fifth year of existence. Some essential features of the current state of play of the implementation and application of the European regulatory framework for the credit rating sector are critically assessed. This paper is to be considered a sketch serving as a starting point for further explorations of the multiple complex legal problems linked to the topic.

1. Some Preliminary Remarks

In the aftermath of the first phase of the financial crisis the regulation and supervision of credit rating agencies (CRAs) in the European Union (Union) have become an increasingly prominent realm of European financial market regulation. It has remained on the agenda of the European legislator. In December 2014, the legally binding regulation of CRAs in the Union will complete its fifth year. In July 2014, the European Securities and Markets Authority (ESMA) will complete its third year as the single supervisory authority for the European credit rating sector. ESMA was conferred on the exclusive power to register and supervise CRAs in the Union shortly after its establishment. It thereby replaced the preceding rather complex, however sophisticated system of co-operation involving particularly the national competent authorities which was introduced by the Regulation (EC) No 1060/2009 on credit rating agencies[1] (CRA Regulation) in 2009.[2] The CRA Regulation is to be considered the fundamental legal act on which the Union's regulation of CRAs is built. It has meanwhile been reformed twice, firstly, by Regulation (EU) No 513/2011[3] (CRA II Regulation) in 2011 and secondly, by Regulation (EU) No 462/2013[4] (CRA III Regulation) in 2013[5].[6] This paper highlights and critically assesses from a legal point of view selected aspects of the current state of play of the implementation and application of the regulation of CRAs in the Union. Focus is on whether the intended goals have been or are likely to be achieved and what challenges are still to be tackled. This includes in particular a critical view from a legal perspective on the effectiveness and efficiency of the instruments available, the institutional design and regulatory approach and the possible effects on the credit rating sector and other financial market participants. The briefing paper ends with a conclusion and outlook. Unless the context suggests otherwise any reference to 'CRAs'

* Gudula Deipenbrock is a professor of Business Law at Hochschule für Technik und Wirtschaft (HTW) Berlin, University of Applied Sciences, Germany.

1 Official Journal (OJ) EU L 302, 17 November 2009, p. 1. The CRA Regulation came into force in December 2009.

2 See G. Deipenbrock, M. Andenas, 'Regulating and supervising credit rating agencies in the European Union', *International and Comparative Corporate Law Journal*, Issue 1, 2012, pp. 10 and 15.

3 OJ EU L 145, 31 May 2011, p. 30. The CRA II Regulation came into force on 1 June 2011.

4 OJ EU L 146, 31 May 2013, p. 1. The CRA III Regulation came into force on 20 June 2013.

5 As the CRA II Regulation and the CRA III Regulation are amending regulations to the CRA Regulation this briefing paper refers to the provisions of the CRA Regulation as amended by the CRA II Regulation and the CRA III Regulation and marks it by referring to 'CRA Regulation (new)', unless expressly stated otherwise.

6 See in this regulatory context also Directive 2013/14/EU, OJ EU L 145, 31 May 2013, p. 1. In addition, various Commission Delegated Regulations supplement the regulatory regime for CRAs in the Union. See e.g. Commission Delegated Regulation (EU) No 446/2012, OJ EU L 140, 30 May 2012, p. 2; Commission Delegated Regulation (EU) No 447/2012, OJ EU L 140, 30 May 2012, p. 14; Commission Delegated Regulation (EU) No 448/2012, OJ EU L 140, 30 May 2012, p. 17.

below shall be a reference to only those CRAs to which the relevant European regulatory rules apply.

2. Intended Goals of the Regulatory Regime for Credit Rating Agencies in the Union

Before turning to the implementation and application of the regulatory regime for CRAs in the Union in more detail, its intended goals shall be sketched out. Informed by the regulatory discussions at international level conducted before the introduction of the regulation of CRAs in the Union in 2009 the (initial) main material objectives of the CRA Regulation are the avoidance of conflicts of interest, the enhancement of the quality and integrity of credit ratings and the transparency of credit rating procedures.[7] The CRA II Regulation did not change these core material objectives as it mainly pursued the goal of institutionally reforming the regulatory regime for CRAs in the Union by entrusting ESMA with the exclusive supervisory power, here.[8] Triggered by the dissatisfaction with the (first) achievements of the regulatory regime for CRAs the Union legislator initiated the legislative procedure of the CRA III Regulation thereby altering also the set of initial intended goals of the CRA Regulation.[9] From the regulatory perspective one might distinguish between the rating-based regulation and the rating-directed regulation. Both realms of regulation are however closely interrelated. The rating-based regulation addresses the use of credit ratings. The rating-directed regulation focuses on the regulation of credit rating activities covering - amongst other issues - in particular the conduct of CRAs. In the realm of rating-directed regulation the initial aims of the CRA Regulation are reiterated or more specified and supplemented by new ones. They cover in particular tackling the oligopolistic structure of the credit rating market, the lack of a European civil liability regime for CRAs, the conflicts of interest due to the issuer-pays model and the CRAs' shareholder structure and solving the problems in the realm of sovereign ratings and the quality of credit ratings in general.[10] In the realm of rating-based regulation the intended goal is to tackle the reliance on credit ratings in standards, laws and regulations and market reliance on credit ratings.[11] Whether or not these intended goals have been or might be achieved is highlighted below.

3. The Current State of Play of the Implementation and Application of the Regulation of Credit Rating Agencies in the Union - Selected Rating-Directed Aspects

A concise overview shall be given of the current state of play of the implementation and application of the registration procedures to be conducted exclusively by ESMA, the material requirements regarding the issuing of credit ratings, selected other instruments available to ESMA and the sanctions including also the newly introduced sanction in the form of a civil liability regime for CRAs in the Union.

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7 For more information on the legislative proposal of the CRA Regulation, see G. Deipenbrock, '„Mehr Licht!"? - Der Vorschlag einer europäischen Verordnung über Ratingagenturen', *Wertpapier-Mitteilungen*, Issue 25, 2009, pp. 1169 et seq.

8 See G. Deipenbrock, M. Andenas, 'Regulating and supervising credit rating agencies in the European Union', *International and Comparative Corporate Law Journal*, Issue 1, 2012, p. 10.

9 The issues considered to require further legislative action are listed in the proposal for the CRA III Regulation of the European Commission (Commission). See Commission, *Proposal for a Regulation amending Regulation (EC) No 1060/2009 on credit rating agencies*, COM (2011) 747 final, 15 November 2011.

10 See Commission, *Proposal for a Regulation amending Regulation (EC) No 1060/2009 on credit rating agencies*, COM (2011) 747 final, 15 November 2011, pp. 8 et seq.

11 See Commission, *Proposal for a Regulation amending Regulation (EC) No 1060/2009 on credit rating agencies*, COM (2011) 747 final, 15 November 2011, pp. 7 et seq.

3.1. The Registration Regime and the Material Requirements Regarding the Issuing of Credit Ratings

At the heart of the regulatory and supervisory regime for CRAs introduced in 2009 lies the registration regime for CRAs established in the Union. A sophisticated interplay between Art. 14, Art. 2 Section 1 and Art. 4 of the CRA Regulation (new) provides for a registration requirement for CRAs established in the Union and links it to the use of credit ratings.[12] The prerequisite for being permitted to carry out credit rating activities in the Union is the successful registration of the CRA established in the Union. ESMA however has also the power to withdraw such a registration under specific conditions. With a view to the implementation and application of the registration procedure the Annual Report 2013 of ESMA on Credit Rating Agencies (CRA Annual Report 2013)[13] gives some guidance. According to the CRA Annual Report 2013 twenty-two CRAs were registered on a group basis and two CRAs certified at the end of 2013.[14] In ESMA's view, registration activities have substantially increased in 2013 in comparison to 2012 and might not decrease in the near future.[15] Apart from the approved registrations in 2013 three applicants withdrew their applications and ESMA refused to register two applicants due to their inability to demonstrate compliance in particular in the realm of independence and quality of credit ratings.[16]

The prerequisite for a successful registration of a CRA is the compliance with the relevant rules of the CRA Regulation (new). It becomes a permanent compliance requirement after the registration. By that the registration procedure is required to not only focus on whether the applicant appropriately demonstrates compliance with the regulatory requirements at the time of application but also on its ability to fulfil its obligations after having obtained the registration.[17] These compliance obligations cover in particular the material requirements in context with the issuing of credit ratings as provided in the CRA Regulation (new). Here, the quality of credit ratings and rating methodologies, the independence of the credit rating process, the disclosure of credit ratings and methodologies, the corporate governance and organisational arrangements are crucial. The CRA III Regulation revisited and amended the initial material requirements in context with the issuing of credit ratings. It extended the scope of the regulatory regime to rating outlooks where appropriate, added further rules on sovereign ratings, amended also - amongst others - the quality regime for credit ratings in particular with a view to the disclosure of rating methodologies, the independence rules by extending them to conflicts of interest due to the shareholding structure of CRAs and added a rotation system in the realm of re-securitisations.[18]

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[12] For more information on this with further references, see G. Deipenbrock, 'Die notwendige Schärfung des Profils - das reformierte europäische Regulierungs- und Aufsichtsregime für Ratingagenturen', *Wertpapier-Mitteilungen*, Issue 39, 2011, p. 1830.

[13] ESMA, Credit Rating Agencies, Annual Report 2013, ESMA/2014/151, 21 February 2014. See also the first two annual reports of ESMA on credit rating agencies for the years 2011 and 2012 (ESMA/2012/3, 12 January 2012, and ESMA/2013/308, 18 March 2013).

[14] ESMA, Credit Rating Agencies, Annual Report 2013, ESMA/2014/151, 21 February 2014, p. 10. For more details on it, see ESMA, List of registered and certified CRAs, last update on 3 June 2013.

[15] ESMA, Credit Rating Agencies, Annual Report 2013, ESMA/2014/151, 21 February 2014, p. 10.

[16] ESMA, Credit Rating Agencies, Annual Report 2013, ESMA/2014/151, 21 February 2014, p. 10.

[17] For ESMA's view on this topic, see ESMA, Credit Rating Agencies, Annual Report 2013, ESMA/2014/151, 21 February 2014, p. 9.

[18] For a more detailed analysis of the CRA III Regulation, see G. Deipenbrock, 'Die zweite Reform des europäischen Regulierungs- und Aufsichtsregimes für Ratingagenturen - Zwischenstation auf dem Weg zu einer dritten Reform?', *Wertpapier-Mitteilungen*, Issue 49, 2013, pp. 2289 et seq. See also G. Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after its Second Reform', forthcoming in the *European Business Law Review*. See also the compilation of papers on the current legal and economic facets of the regulation and supervision of CRAs in the Union, edited by G. Deipenbrock, M. Andenas, forthcoming as a special issue of the *European Business Law Review*.

3.2. Selected Other Instruments and Sanctions

Apart from the registration and certification procedures the CRA Regulation (new) provides for instruments in context with the supervision of CRAs as well as measures and sanctions. In order to effectively supervise the European credit rating sector various instruments are available to ESMA. In the realm of policy the issuance and update of guidelines and the submission of draft regulatory technical standards for adoption by the Commission according to Art. 21 of the CRA Regulation (new) are relevant. In order to implement the CRA III Regulation for instance ESMA has to submit in particular three draft regulatory technical standards by 21 June 2014 on the information on structured finance instruments, the new European Rating Platform[19] and the periodic reporting on fees charged by CRAs.[20]

ESMA might exercise its supervisory powers also by means of the instruments provided in particular in Art. 23b et seq. of the CRA Regulation (new) including requests for information, general investigations and on-site inspections. The supervisory measures are subject to detailed procedural rules.[21] ESMA conducted so far particularly general, thematic and individual investigations which - in the case of thematic investigations - resulted in imposing action plans on the CRAs involved.[22] ESMA recognises an increasing compliance of CRAs with the regulatory regime in some areas such as the compliance function within CRAs and transparency and disclosure regarding credit rating activities but identifies also compliance deficits in other areas such as the validation of rating methodologies, internal governance and robust IT systems of CRAs.[23]

In addition, ESMA might also impose on CRAs fines or periodic penalty payments according to Art. 36a et seq. of the CRA Regulation (new). In order to supplement the set of sanctions the CRA III Regulation introduced for the first time a European civil liability regime for CRAs in the Union. Under Art. 35a of the CRA Regulation (new) investors or issuers might claim damages from a CRA under specific circumstances in case of an infringement of specific regulatory rules by that CRA. The Union legislator however did not create a complete and detailed European civil liability norm defining all of its constituent elements but rather a fragmentary civil liability provision which has to be complemented by the relevant applicable national law.[24]

3.3. Miscellaneous

It might suffice for the purposes of this briefing paper to concisely note that the CRA III Regulation introduced also the tool of a European Rating Platform and a further specified requirement of a double credit rating of structured financial products in context with the goal of tackling the oligopoly in the credit rating sector.

[19] See item 3.3.
[20] ESMA, Credit Rating Agencies, Annual Report 2013, ESMA/2014/151, 21 February 2014, p. 21.
[21] For more information on this, see R. Veil and L. Teigelack in R. Veil (ed.), *European Capital Markets Law*, Hart Publishing, Oxford and Portland, Oregon, 2013, p. 427.
[22] ESMA, Credit Rating Agencies, Annual Report 2013, ESMA/2014/151, 21 February 2014, pp. 3 et seq.
[23] ESMA, Credit Rating Agencies, Annual Report 2013, ESMA/2014/151, 21 February 2014, pp. 4 et seq.
[24] For more information on this, see e.g. A. Dutta, 'Die neuen Haftungsregeln für Ratingagenturen in der Europäischen Union: Zwischen Sachrechtsvereinheitlichung und europäischem Entscheidungseinklang', *Wertpapier-Mitteilungen*, Issue 37, 2013, pp. 1729 et seq.

4. The Current State of Play of the Implementation and Application of the Regulation of Credit Rating Agencies in the Union - Selected Rating-Based Aspects

With a view to the rating-based elements of the regulatory regime for CRAs the rules aiming to tackle the overreliance on credit ratings are relevant. The European legislator not only adopted in particular Directive 2013/14/EU[25] in this context. The CRA III Regulation also addresses the overreliance on credit ratings by financial institutions, by the European Supervisory Authorities and the European Systemic Risk Board, and in Union law by inserting the new Art. 5a et seq. to the CRA Regulation.[26]

5. Achievement of the Intended Goals and Challenges - A Critical View

This paper critically assesses below several of the concisely depicted aspects of the status quo of the CRA regulation in the Union.

5.1. A Critical View on Selected Aspects of the Implementation and Application of the Regulatory and Supervisory Regime

With a view to the current state of play of the rating-directed regulation some critical observations appear to be justified. Firstly, against the backdrop of ESMA's account of the registration activities in the CRA Annual Report 2013[27] one might conclude that the emphasis the CRA Regulation has placed from the very beginning on the registration procedure is reflected also in practice. Secondly, with a view to measuring the impact of ESMA's supervisory activities in general one might concur with ESMA's opinion that this is work in progress.[28] In particular the CRA Annual Report 2013 exemplifies how complex and multi-layered the regulation and supervision of the credit rating market as only one sector of the European financial market have become within only less than five years. The single supervisory authority approach has proved itself crucial for an efficient and effective implementation of the regulatory regime for CRAs in the Union. Thirdly, however, in the realm of sanctions the civil liability regime for CRAs in the Union newly introduced by the CRA III Regulation has to be viewed with criticism. The civil liability of CRAs as provided in Art. 35a of the CRA Regulation (new) requires an in-depth analysis which lies beyond the scope of this paper. Amongst other critical issues the burden of proof rule might become a major obstacle to the effective implementation of this new provision. Various uncertainties are linked also to the design and phraseology of Art. 35a of the CRA Regulation (new) in general. In addition, multiple problems arise in context with its interpretation and application in particular in the realm of private international law. The Union legislator only gives the bare bones of the civil liability concept for CRAs. The relevant applicable national law comes into play when interpreting and applying the essential constituent elements of the civil liability provision which are referred to but not defined. It shall govern also the matters related to the civil liability of CRAs which are not covered by the CRA Regulation. The applicable national law is to be determined by the relevant private international law rules. To this end the relevant private international law rules have to be determined in advance. Already the determination of the relevant private international law rules raises multiple legal questions. Hence, this dogmatic approach increases the intricacy of the provision. Although the present author takes the view that the current rules of private

[25] OJ EU L 145, 31 May 2013, p. 1.

[26] For a more detailed analysis of this group of amendments of the CRA III Regulation, see G. Deipenbrock, 'Die zweite Reform des europäischen Regulierungs- und Aufsichtsregimes für Ratingagenturen - Zwischenstation auf dem Weg zu einer dritten Reform?', *Wertpapier-Mitteilungen*, Issue 49, 2013, pp. 2294 et seq. See also G. Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after its Second Reform', forthcoming in the *European Business Law Review*.

[27] ESMA, Credit Rating Agencies, Annual Report 2013, ESMA/2014/151, 21 February 2014, pp. 9 et seq.

international law address this form of tort in financial markets, the lack of predictability of the multiple national laws to be applied in context with Art. 35a of the CRA Regulation (new) might stir up a further controversy over connecting factors in the realm of credit rating sector torts or financial markets torts in general.[29] It appears to be open even before its implementation in practice whether the civil liability regime for CRAs in the Union is appropriately designed to supplement the regime of supervisory instruments and sanctions available under the CRA Regulation (new).

As to the current state of play of the new rules in the realm of rating-based regulation as introduced by the CRA III Regulation it is not possible to assess at this stage whether they will achieve the intended goal of reducing reliance on credit ratings. Particularly the planned removal of references to credit ratings in Union law for regulatory purposes is dependent on whether appropriate credit risk assessment alternatives will have been identified and implemented.[30] The final outcome of the process of identification and implementation of alternative credit risk assessments remains to be seen.

5.2. A Critical View on Selected Aspects of the Institutional Design and Regulatory Approach from a Broader Perspective

From the institutional perspective the Union's single supervisory authority approach is highly conducive to the achievement of the intended goal of an effective and efficient supervision of the credit rating sector in the Union.[31] The aspect of ESMA's staffing and resources however remains a crucial point not only with a view to the important role ESMA plays in the legislative procedure regarding the regulatory technical standards but also regarding the increasing workload and complexity of the tasks to be fulfilled. In this context Art. 39a of the CRA Regulation (new) requires ESMA (again) to submit a new assessment of its staffing and resources needs by 21 June 2014.

From the regulatory perspective tensions arise from the combination of elements of rating-directed and rating-based regulation.[32] On the one hand the Union legislator increases the level of rating-directed regulation to allow the market to regain trust in credit ratings. On the other hand overreliance on credit ratings shall be tackled. In the present author's view the main emphasis should be placed on the objective to decrease overreliance on credit ratings in the realm of rating-based regulation. Once this objective is achieved the risks linked to the overreliance on credit ratings will have been mitigated also so that the level of regulating credit rating activities might not require any further increase.

A general observation on how to ensure good regulation from a broader perspective might be allowed also. The CRA III Regulation contributed considerably to the increase in volume and complexity of the regulatory rules for CRAs. Three aspects of this critical development might be highlighted. Firstly, the complexity increased from the legal point of view. One example of this legal complexity is - amongst other provisions - the new civil liability

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[28] ESMA, Credit Rating Agencies, Annual Report 2013, ESMA/2014/151, 21 February 2014, pp. 4 et seq.

[29] For more information on this, see G. Deipenbrock, 'The European Civil Liability Regime for Credit Rating Agencies from the Perspective of Private International Law - Opening Pandora's Box?', forthcoming. For a concise assessment of the new civil liability provision, see also G. Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after its Second Reform', forthcoming in the *European Business Law Review*.

[30] However, with a view to the implementation of Art. 5b of the CRA Regulation (new), see Joint Committee of the European Supervisory Authorities, Final Report on Mechanistic References to Credit Ratings in the ESAs' Guidelines and Recommendations, JC/2014/04, 6 February 2014.

[31] For more information on this and the preceding institutional design with further references, see M. Andenas, G. Deipenbrock, 'Credit Rating Agencies and European Financial Market Supervision', *International and Comparative Corporate Law Journal*, Issue 3, 2011, pp. 10 et seq.

[32] For more information on the conflicting objectives in this context, see I. Chiu, 'Regulating Credit Rating Agencies in the EU: In Search of a Coherent Regulatory Regime', forthcoming in the *European Business Law Review*.

regime for CRAs. Secondly, the drafting style is often too complex and voluminous. Examples might be easily found in particular in the German and English version of the text of the CRA III Regulation. Plain language appears to be in need, here. Thirdly, the more (extensive) reforms will be enacted the more complex will just the search for the relevant rule in a specific case become. For any future reforms the present author's ceterum censeo remains a plea for a more principle-based approach with an emphasis on simplicity and discretion instead of complexity and further details.

6. Possible Effects on the Credit Rating Sector and Other Financial Market Participants

The registration activities of ESMA as outlined in particular in the CRA Annual Report 2013 show that the registration is a procedure that is not successfully completed by all applying CRAs. ESMA appears to be required to strike a balance between employing the registration procedure as a strict gateway to the credit rating market and at the same time avoiding setting the bar too high thereby creating an insurmountable market entry barrier for smaller CRAs. Apart from that the application of the various supervisory instruments, in particular the investigations conducted by ESMA might well be considered to have a positive effect on the compliance of registered CRAs with the regulatory regime. It remains to be seen what impact the newly introduced European civil liability regime for CRAs will have on the market participants. Any effects of it might only be appropriately assessed in several years.

7. Conclusion and Outlook

This outline regarding the status quo of the implementation and application of the regulatory and supervisory regime for CRAs in the Union after 'CRA III' shows that considerable progress has been made with a view to rating-directed regulation. However, the CRA III Regulation might not be considered to have played so far or play an important part in tackling the dysfunctions of the European credit rating sector. The achievement of the ambitious goals of the CRA III Regulation in the course of its further implementation appears to be rather questionable. For any future reform a recollection of a more principle-based instead of an ever more complex regulation is in need. The most pressing challenge however lies in the realm of the rating-based regulation where the problem of overreliance on credit ratings has to be sustainably resolved.

2. AN ECONOMIC ANALYSIS OF CREDIT RATING MARKETS AND REGULATION

Dion BONGAERTS, Rotterdam, Netherlands

Abstract

This paper analyses the expected effectiveness of the CRA3 regulation from an economic perspective with the emphasis on feasibility and the strengthening of CRA reputation. Strong and weak points are indicated and suggestions for improvement are provided. Additionally, comments and suggestions for improvement for sovereign rating regulation in CRA3 are provided.

Executive Summary

This paper analyses the effectiveness of the CRA3 regulation in preventing (welfare losses resulting from) credit rating failures.

The paper gives an overview of the role of CRAs in an economy and under which conditions their ratings can be relied on. It also shows why reputation fails to discipline CRAs when external benefits of investing or issuing are high and products are complex.

Next, several measures in the CRA3 regulation are analysed using this economic framework. Particular attention is paid to feasibility and the contribution of these measures to strengthening the effectiveness of CRA reputation in stimulating the production of accurate ratings. Some measures such as increased transparency can be expected to strengthen reputation effects, while others such as civil liability and removing regulatory references to credit ratings will be very hard to implement properly. Several measures such as stimulating competition or mandatory CRA rotation may also have negative side effects that can even undermine CRA reputation. Several alternative measures are suggested too.

The analysis yields the following set of recommendations:

1. Tailor regulation to specific products
2. More research on stimulating competition and rotation
3. Add automatic punishment to civil liability
4. Develop contingency plan for over-reliance
5. Require CRAs annual account disclosure
6. Reduce product complexity
7. Check reputation effect of all (proposed) regulation

Regarding sovereign ratings, an analysis is first conducted to assess the conditions under which a special regulatory regime for sovereign ratings may be desirable. After all, sovereign downgrades may amplify budgetary problems during a crisis, but can also prevent crises from happening by inducing budgetary discipline. A special sovereign rating regime would only be desirable when financial distress resulting from sovereign rating downgrades is disproportionally damaging. Sovereign rating ceilings for corporates may be a reason for this disproportionality.

While some measures such as sovereign rating supervision by ESMA could reduce (unjustified) sovereign distress, others, such as the rating calendar, could undermine budgetary discipline and undermine confidence in markets.

The analysis yields the following set of recommendations:

1. Reconsider special sovereign rating treatment
2. Continue sovereign rating supervision
3. Consider using ratings to strengthen fiscal discipline
4. Withdraw rating calendar
5. Consider regulation relating to sovereign ceilings

1. Background

Recently, Credit Rating Agencies (CRAs) have come under substantial scrutiny. This increased public and regulatory scrutiny originates from two market developments.

1. Many highly (often AAA) rated structured products, especially those directly or indirectly backed by U.S. sub-prime mortgages showed high default rates and large value losses; in other words, ratings turned out to be too lenient ex-post.
2. Several sovereign nations were downgraded when already experiencing financial distress. Allegedly, these downgrades increased financial distress losses and amplified the European sovereign debt crisis. Here CRAs were accused of being too stringent.

Based on those episodes, specific regulation has been proposed, both in the U.S. as well as in the E.U. to prevent such episodes from repeating themselves. Within the EU, the most recent set of CRA regulations originate from the CRA3 regulation. In this regulation, measures are developed along roughly three lines:

1. Improve incentives for CRAs to produce accurate ratings
2. Make the system less sensitive to rating changes and thereby to rating failures
3. Build a special, protected position for sovereigns

These different sets of measures will be analysed in more detail in the sections to follow. However, before doing so, it is useful to conduct an analysis on the economics of credit ratings and the origins of these (alleged) rating failures. The resulting insights will help to assess the effectiveness of the CRA3 regulations.

2. The Economics of Credit Ratings

2.1. Why would credit ratings be useful?

Many business transactions involve a certain degree of credit risk. One can think about trade credit, corporate bonds or repackaged mortgages. The degree of credit risk involved generally affects the willingness of businesses to conduct certain transactions as well as the prices at which these transactions take place. However, credit risk is not readily observable and requires thorough analysis to be measured. Having each party do this independently would lead to inventing the wheel over and over again. Dedicating this task to a small number of specialized agencies seems to be an efficient solution to this problem.

The birth of CRAs in the late 19th and early 20th century was followed by the great depression. During the great depression, many banks went under, which caused massive economic disruptions. Regulators recognized the importance of limiting banks risk taking

and embedded CRAs strongly into the financial system as external gatekeepers (Partnoy, 2001). The idea was that contrary to banks, CRAs do not invest and therefore do not have a vested interest in the rating they produce. Based on this thought, more and more regulation started to involve credit ratings as independent measures of credit risk. This independence also made credit ratings very popular in private contracting, for example for collateral requirements and repo haircuts.

Concerning bond markets, credit ratings offer two additional advantages. First, bonds are often widely held and as a result, no single creditor will have strong incentives to monitor and discipline the bond issuer. An external agency that has credit assessment as its core business may find it easier to commit to monitoring; discipline will then arise from price/interest rate/demand changes following rating announcements. Second, in contrast to loans, bonds are tradable among investors. The easier it is to trade a bond, i.e. convert it into cash, the more popular a bond will be and therefore, the lower the interest rate on the bond can be (Bongaerts et al., 2013). One can imagine that it is easier to find counterparties to trade with if investors have the confidence that in general they do not trade with better informed parties. Credit ratings help to achieve a level playing field in terms of information about credit risk (Bongaerts et al., 2012).

2.2. Incentives for CRAs, reputation and funding models

Why would ratings be trustworthy? After all, rating accuracy is not easily verifiable and hiring a good credit analyst is costly. The mechanism that disciplines CRAs (as well as any other service provider or producer of a product of non-verifiable quality) is reputation (Shapiro, 1982).

To understand the role of reputation of rating agencies in credit markets, one needs to look at the three key types of market participants: CRAs, investors and issuers.

A **CRA** will do its job well if

Current gains from misbehavior ≤ Loss of expected future profits (1)

The loss of expected future profits will be mainly due to market parties not trusting the CRA anymore and in turn, a lower demand for a CRA's services. Condition (1) will be the crucial reference point in this document and most regulation will be evaluated using this condition.

Investors will only buy a bond with a specific rating when:

Expected interest + external benefits of investing ≥ Expected loss + risk premium (2)

Expected losses in equation (2) will be higher for bonds with i) low ratings and ii) ratings from a CRA that is believed to produce inaccurate ratings. External benefits of investing are for example management fees to fund managers that are paid for making the investment, irrespective of its quality. Hence, rating inflation would increase the minimum required interest rate on a bond because expected losses increase. But this increase could be mitigated if investors are competing demand for bonds they can invest in to pocket external benefits.

Finally, **issuers** aim for getting ratings that maximize

Operating profits – expected interest– rating fees + external benefits of operating (3)

Naturally, issuers want to maximize their net profit. Net profit consists of operating profit minus their funding costs (which include the costs/fees for getting a rating). On top of that, issuers may derive an external benefit from operating. For example, a CEO may enjoy a luxury lifestyle that comes with the job irrespective of his performance, or an investment banker might get a bonus for securitizing a pool of mortgages irrespective of the interest rate he achieves to get.

If issuers and investors enjoy no external benefits, then both investors and issuers will look for CRAs that strike a good balance between rating fees and accuracy. This way, investors can have confidence that they invest in relatively safe bonds and keep interest low (follows from condition (2)). Low interest rates maximize the competitiveness of investors and are of course to the benefit of the issuers.

Discipline by reputation is very profitable for CRAs. In order for condition (1) to hold, fees need to be relatively high compared to rating production costs, otherwise there is too little future profit to be lost. Hence, CRAs must have high profit margins for reputation to work! (Shapiro, 1983 and Bongaerts, 2014)

But which party should pay these relatively high rating fees? Initially, investors paid CRAs for manuals containing credit ratings (see also Sylla, 2001). Hence, we had an investor-paid model. The investor-paid model however is prone to free-riding of several sources. For example, intellectual property may be hard to protect and ratings may be shared with investors that have not paid for them. Moreover, subscribing investors need to recover the costs for purchasing ratings from transaction fees and interest rate markups on loans and bonds. However, issuers that receive low ratings are unlikely to take out loans or issue bonds and hence do not generate revenues for subscribing investors. However, these investors have paid for getting these ratings. As a result, subscribing investors need to recover these costs by charging issuers with high ratings relatively high interest rates and transaction fees (Bongaerts, 2014). This makes funding for promising projects unnecessarily expensive.

In the '70s, a more cost-efficient business model arose, the issuer-paid model. Not surprisingly, this happened shortly after the large scale adoption of the Xerox copier (which made it much easier to violate intellectual property rights). With issuer-paid ratings, issuers select CRAs and pay them for their services, irrespective of the outcome. Only high ratings from CRAs that are believed to be produce accurate ratings lead to lower interest rates for issuers. Therefore, only issuers that expect to benefit from ratings are willing to pay a rating fee and many low quality issuers do not bother to ask for a rating and rating production costs can be avoided for those issuers. Hence, the issuer-paid model is more cost efficient and has become dominant after its introduction.

Note that there is no reason to assume that the low cost-efficiency of investor-paid CRAs has changed since the 70s. Consistently, several (recent) investor-paid CRA initiatives (such as the Roland Berger initiative in Europe) have been terminated before getting started.

2.3. Misbehaviour, rating shopping and rating inflation

For decades, the issuer-paid business model seemed to work fine. Several studies indeed confirmed that reputation effects (usually measured in U.S. corporate bond markets) were sufficiently strong to enforce accurate ratings (e.g. Covitz and Harrison, 2003). It is also worth noting that apart from some individual incidents (e.g. Enron), to this day, there have been no large scale accusations of low ratings accuracy in the corporate bond market. Consequently, credit ratings got an ever more prominent role in the regulation of financial institutions.

Why then was ratings accuracy so poor in the structured product market? One should keep in mind that issuers and investors strive for high rating accuracy as long as they derive no external benefits from operating or investing. However, this assumption was most likely violated in structured product markets. Investment bankers (in this case the issuers) were offered large, short-term bonuses or other forms of compensation for issuing products with AAA ratings (one can find some examples in Lewis, 2010). More concretely, these external

benefits resulting from inflated ratings increase equation (3) substantially. This increase is insufficiently offset by higher interest rates to prevent issuers from shopping for inflated ratings.

Moreover, similar short-term bonus plans and other external benefits may have incentivized bankers and investors to take on excessive amounts of risk. Condition (2) then tells us that, even when investors were aware of rating inflation (results in He et al., 2012 suggest at least some were), interest rates would not increase enough to compensate for the resulting elevated credit risk. As a result, issuers would even benefit (indirectly, through low interest rates) from anticipated rating inflation (Bongaerts, 2014). Once again, this would induce issuers to shop for inflated ratings.

Finally, in contrast to regular bond markets, the expected volumes coming from individual issuers were much higher, whereas the number of issuers was much lower. As a result, individual bargaining power of issuers was much higher (He et al., 2012) allowing issuers to credibly link rating inflation to future expected gains rather than losses.

Looking back at condition (1), one can understand why ratings of structured products failed. First, misbehaviour in the form of rating inflation would contemporaneously lower costs (fewer analysts required) and increase volumes (due to rating shopping from issuers). As structured products are complex and therefore costly to rate, reducing rating effort would also lead to large cost savings. Second, issuers that received inflated ratings would be more rather than less likely to come back for more ratings. Third, as these products were new and complex, rating shopping and rating inflation was hard to detect and hence the probability of losing future business due to lack of trust was low (Skreta and Veldkamp, 2009). Being at the peak of a business cycle amplified these effects as wages for good analysts were high (leading to high gains from contemporaneous misbehaviour) and low rating accuracy is hard to detect (at least in the short run) when there are hardly any defaults (decreasing the expected loss of future profits). (Bar-Isaac and Shapiro, 2013)

2.4. Can CRA3 mitigate market failure due to rating inflation?

2.4.1. General assessment

In general, the measures proposed in CRA3 are aimed to reduce conflicts of interests and lower the market impact of rating failures. As such, it offers solutions to the causes and symptoms of rating inflation. However, the regulation as is may be rather costly to implement and at some points less effective than hoped for.

What is striking about CRA3 is the volume of additional regulation imposed on CRAs. The additional rules for CRAs will increase administrative costs for CRAs and potentially also several other market participants. The resources allocated to satisfying these regulations will be reflected in higher rating fees. In the absence of external benefits, higher fees can induce issuers to settle for lower accuracy (as accuracy becomes more expensive) and will make it harder for firms to access the bond market. With banks cutting back on lending, this is undesirable. As many of administrative costs are fixed in nature, additional barriers to entry are being imposed (although the regulations contain room for supporting/exempting small CRAs).

Moreover, when reading the regulations, one would think that there have been large rating failures in all types of rated assets. This is not the case. It has primarily been structured products and contestably sovereign bonds. One can wonder whether the costs of these measures do not outweigh the benefits for well-performing and well-understood asset classes. For corporate bond ratings, many of the regulations introduced with CRA3 may be costly and unnecessary.

Finally, in such a highly regulated regime, there is a substantial risk that through political pressure CRAs might be influenced to inflate sovereign ratings or ratings of for example systemically important banks. After all, with so many rules and some degree of discretion in interpreting those, violations can always be found. To prevent this, additional provisions that protect ESMA and CRAs from political influence may be desirable.

2.4.2. Stimulating competition and the use of small CRAs

One of the objectives of CRA3 is to stimulate competition among CRAs, with an explicit focus on fostering small CRAs. Let us again analyse the effects of such policies from an economic perspective.

Several studies have shown both theoretically and empirically, that competition among CRAs generally leads to lower rating accuracy due to increased rating shopping opportunities (see e.g. Bolton et al, 2012 and Becker and Milbourn, 2011). Moreover, increasing competition lowers expected future profits and hence may lower the disciplining power of reputation in condition (1) (Camanho et al., 2012). Additionally, a single client may be relatively more important for a small CRA than for a large CRA. Therefore, a small CRA may be more inclined to cater to an individual issuer. From an incentive perspective, it is therefore unclear why small CRAs would be preferable over large CRAs.

More competition would however give regulators a more credible threat to really revoke a rating license upon bad performance, as the market would not shut down instantly upon doing so. The increased credibility of regulatory action would increase the '*expected future profit to be lost'* in condition (1). More independent assessments could also improve the aggregate view of the market on an issue. However, it is unclear whether each issue will be rated by many more CRAs when competition is more severe. Finally, small CRAs could be preferred over large ones, since they carry lower systemic importance and can more easily be punished without disturbing markets and existing contracts too much. Hence, discipline in condition (1) could be stronger for small CRAs.

2.4.3. Reducing over-reliance and stimulating independent assessment

Several measures have been proposed to reduce the institutional importance of credit ratings. Academic studies have also shown that regulatory importance can lead to rating inflation, especially for complex products (Opp et al., 2013). One of the measures introduced is to look for alternatives to replace (issuer-paid) credit ratings. Over-reliance on CRAs can only be effectively taken on if references to credit ratings also disappear from bilateral contract (so-called mandates). Ideally, one would have a proper alternative that the whole market agrees on. This makes financial contracting very efficient and prevents surprises such as certain types of collateral unexpectedly not being accepted. However, such alternatives may themselves become subject to over-reliance. Moreover, those alternatives will be hard to find. A few candidates are discussed below.

Investor-paid ratings are cost inefficient as explained above and can therefore hardly compete with issuer-paid ratings. Difficulties to protect intellectual property may even prevent investor-paid ratings to function well in the absence of issuer-paid CRAs (see also Bongaerts, 2014).

Underwriting or investor-produced rating models would generate compromise independence and go against shareholding regulations in CRA3. Moreover, when investors have risk-taking incentives, such models could even amplify rating inflation further (Bongaerts, 2014).

Market price based measures such as CDS spreads would show excessive fluctuations. Moreover, those would not only measure default risk, but also contain risk premia. Finally, as credit markets are relatively illiquid, manipulation would be relatively easy.

Of course, other alternatives may exist. However, for any of those candidates, incentives to manipulate the measure could be substantial, especially if implemented market-wide. Therefore thinking about alternatives to removing all regulatory references to ratings may be required.

From an incentive perspective, providing CRAs with the end of their existence on the horizon would undermine their reputational incentive contemporaneously (i.e. reduce the right hand side in condition (1)).

That having said, one-sided markets upon downgrades and the large impact of idiosyncratic or even systematic rating errors are of course undesirable (see among others Ellul et al., 2011). One-sided markets are already contained to some extent by the CRAs themselves due to using of watch lists and slow and gradual downgrade processes (Altman and Rijken, 2004). One could limit one-sided markets even more by allowing longer regulatory transition periods upon downgrades (e.g. capital charges for downgraded credit increase gradually over a period of half a year towards the capital charge that belongs to the new rating).

The encouragement for investors to do their own credit assessment might only resort little effect. If investors had wanted to conduct more thorough screening, they could already have done so. Moreover, with Basel II/III and Solvency II, large financial institutions will already be required to do their own credit assessment. One should also realize that in the presence of external benefits of investment, investors also have incentives to inflate credit assessments.

2.4.4. Transparency

In general, increased transparency can be expected to improve ratings accuracy in several ways. First, properly motivated rating reports will make verification by investors easier. Moreover, providing a database with ratings data such as the European Rating Platform managed by ESMA would help market participants and academics to assess rating accuracy and CRA reliability and potentially uncover opportunistic behaviour.

On the other side, there are also dangers in the sense that rating shopping might be facilitated this way. It will now become easier for issuers to spot which CRAs issue more optimistic ratings for similar firms. Issuers could then selectively solicit ratings. Another danger I see is that CRAs have to make their methodology public and allow issuers and investors to comment. If industry lobby groups pick this up and organize well, they could try to influence rating models in systematic ways. Moreover, detailed information about rating models is provided this way, which makes it easier to find the weak spots and game the models. On aggregate however, I would expect the benefits of increased transparency to outweigh the disadvantages.

There is one aspect that could be considered to be added to the transparency requirements. This is the financial position of the CRAs themselves. As is usual with listed companies, it would be highly desirable to make income statements and balance sheet requirements of CRAs available to the public. These financials can be important in assessing the reliability of a CRA. CRAs that have lost substantial market shares may experience pressure to exert insufficient effort and care in producing ratings in an effort to gain market share and cut costs. Similarly, low costs per rating may be an indication of insufficient thoroughness in the rating process. Finally, low profit margins may indicate insufficient '*reputational capital'* (i.e. the right hand side in condition (1) is too small). (Bongaerts, 2014)

2.4.5. Fees

CRA3 introduces a provision on the way fees should be set. The guiding principle put forward is that fee should be non-discriminatory, not dependent on rating outcomes and proportional to production costs. Having fees that depend on rating outcomes are indeed undesirable, as they facilitate rating shopping (Sangiorgi et al., 2009) and increase the left hand side of condition (1) and hence give incentives for rating inflation. Moreover, issues that receive low ratings do not generate income for CRAs and fees for high quality issuers need to be increased to compensate. Having rating fees proportional to production costs would be fine. However, production costs are hard and costly to measure and ways may be found to engage into the desired price discrimination anyway (if any). For example, it is unclear what 'proportional' would mean in the presence of many types of large fixed costs as those can be allocated to individual ratings in many different ways. Moreover, it is crucial for reputation and competition to work, that profit margins per rating are allowed to differ across asset classes or even industries. In order for condition (1) to generate strong enough incentives, profit margins need to be high for asset classes where rating inflation is hard to detect. For asset classes where rating inflation is easily detected, profit margins and hence fees can me much lower.

On a related note, one may want to think a bit more concretely about rating costs themselves. At the moment, rating analysts are close to the bottom of the market salary-wise. This may be undesirable in the sense that i) CRAs do not attract the top talents and ii) revolving door type of issues (Cornaggia et al., 2013) could play up. Of course, higher analyst wages will lead to higher rating fees making the hurdle for issuers to access bond markets higher. More discussion on this topic seems to be justified.

2.4.6. Civil liability

CRA3 also introduces civil liability of CRAs. In principle, this sounds like a good idea as it would reduce the expected gains from misbehaviour or increase future expected losses in condition (1). Hence, reputation based discipline can be expected to become more effective, potentially leading to higher accuracy and lower fees. The question is whether the current implementation is sufficiently effective. My expectation is that gross negligence or bad intent may be very hard to prove in court. To the best of my knowledge, gross negligence would be determined based on whether a CRA would fail to satisfy certain regulatory requirements. However, such a '*checkbox*' approach is by definition incomplete and regulatory/administrative costs can be expected to be substantial. In addition (or even instead), one could consider automatic punishments (e.g. revoking licenses, fines) if ex-post accuracy of a new product turns out way out of line with historical statistics on established products. While this may lead to some (excess) conservatism, it would also prevent excessively complicated products and products with large systematic components to be rated or even developed. In the end, the prime goal is to prevent large shocks to the system. Therefore a rather wide margin for ex-post tolerable accuracy can be employed (otherwise CRAs can be expected to become excessively conservative in their ratings).

2.4.7. Mandatory rotation

In order to avoid one-sided views and avoid the fostering of too intimate relationships over time, a rotation mechanism is proposed for the industry as a whole. It is implemented for re-securitizations as an experiment. One could open Pandora's Box by introducing such regulation as the economic dynamics resulting from such a system a very complex. From an economic perspective, all kind of seasonal and strategic patterns could arise. In addition, reputation with the same issuer will be limited as future profits from that issuer are limited. The crucial question is how contemporaneous and historical rating decision and

accuracy will affect the selection process done by other issuers. The exact workings of such mechanisms are unclear and deserve more research. One could for example imagine that such a rotation requirement would stimulate issuers to think about rating shopping opportunities.

For these reasons I appreciate the decision to first experiment with an asset class that works more or less on an ad-hoc basis (i.e. re-securitizations). However, proper monitoring and evaluation after a relatively long period (at least containing a full business cycle) would be recommended. One could also learn from the implementation of similar systems in the accountancy world, as for example recently implemented in the Netherlands.

2.4.8. Other thoughts and avenues to explore

In addition to fixing conflicts of interest that CRAs are exposed to, the deeper causes of the failures of reputation could also be addressed. To some extent, this has already been done in other directives, for example by increasing capital requirements, and limiting short-term bonuses (in CRD IV). Additionally, regulators might consider limiting complexity and putting in place checks and balances that are hard to arbitrage. Limiting complexity makes it easier to detect rating inflation and therefore, allows reputation to be more effective (the probability of losing future profits in condition (1) increases) and rating fees to be lower. For example, regulators could consider only issuing rating licenses for products that conform to a limited number of standard structures (determined by e.g. ISDA). This would also close off many ways to arbitrage the system and make it easier for market participants (and regulators) to do their own due diligence. Additionally, one could consider allowing only products with a complete and self-contained prospectus not exceeding e.g. 20 pages of text with standard formatting to be rated.

2.4.9. Recommendations

Based on the above analysis, my main recommendations can be summarized as follows.

1. Tailor regulation more to specific product segments
2. Do more research on the costs and benefits of stimulating competition and rotation
3. Develop back-up plan to reduce over-reliance if proper alternatives cannot be found
4. Require CRAs to disclose their annual accounts
5. Develop automatic punishment for extremely low rating accuracy in addition to civil liability
6. Explore avenues to reduce complexity in the system in a robust way
7. Analyse the effect of any regulation on the CRA reputation condition (1)

3. SOVEREIGN RATINGS

Whereas ratings for structured products were accused of being too optimistic, sovereign ratings have come under increased scrutiny because of being too stringent and unnecessarily disruptive. As a result, the CRA3 regulation contains articles dedicated to mitigating the effect of rating adjustments on sovereign bond prices. I am not convinced about the desirability of special positions for governments, but can imagine that certain additional checks and balances may be justified.

3.1. Background on sovereign ratings and sovereign debt

Sovereign debt is the debt of individual countries. Contrary to corporates, sovereigns do not have equity holders; the closest thing to an equity holder is a (tax-paying) citizen. Moreover, in case of bankruptcy, creditors typically cannot take control of a country's assets, but can deny new funding to the government. Typically, financial distress of governments leads to austerity, which tends to triggers negative economic cycles.

Financial distress for governments with their own currency is bad enough, but generally, they can restructure/default on some of the (foreign) debt, their currency depreciates and economic growth can slowly pick up again. Iceland is a good example of such a process. Matters are more complicated in a Monetary Union such as the euro area. Currency depreciation is hardly an option in the presence of large regional differences. Moreover, sovereign debt problems can become contagious leaving ever fewer healthy countries to support the distressed ones. In view of these consequences one would expect very tightly enforced budgetary policies.

The existence of sovereign ratings follows the same logic as for corporate ratings. However, the ratings of most Western countries are unsolicited. That is, ratings are unasked for and produced based on publicly available information. Hence, any investor would be able to do his or her own analysis based on the same data and verify the accuracy of sovereign ratings.

3.2. Desirability of exceptions for sovereign ratings

Why would there be a need to regulate sovereign ratings extra tightly? There would be roughly two situations in which this would be justified. First, CRAs could intentionally have issued inaccurate, and in particular, overly pessimistic ratings. It is hard to come up with incentives for CRAs that justify such behaviour. The only ones I can think up is restoration of reputation and retaliation for the introduction of heavy regulation. A more realistic problem might be that in view of the unsolicited and hence unprofitable nature of sovereign ratings, CRAs assign inexperienced (and hence cheap) staff to sovereign rating teams. The second situation is where sovereigns for some reason suffer disproportionally from downgrades. This is especially problematic when downgrades are unjustified. Indeed, investors are still subject to ratings-based regulation and even when ratings carry little information, downgrades could increase interest rates. This is however also true for other types of ratings and hardly a reason to label downgrade effects to be disproportional. A more serious issue is that sovereign ratings often cap ratings of corporations residing in that country. This could in a mechanical way lead to tighter credit and higher funding costs for the whole corporate sector of a downgraded country (Almeida et al., 2014). This practice may give rise to disproportionate damage, although linking corporate to sovereign ratings may be justified for a subset of these corporates. After all, in distressed countries tax rates are expected to increase, sales to drop, and banks may be forced to purchase their own sovereign's debt.

On the other hand, ratings could play an important governance mechanism in enforcing the budgetary discipline that is required within a monetary union. Budgetary discipline can come from (domestic) voters, international politics and financial markets. Voters may lack the financial literacy or trust in the system to vote for budgetary discipline. Moreover, they may have an incentive to let other generations or other participating countries pick up part of the costs of over-spending. Politics may be limited by a similar lack of financial expertise, have similar incentives to postpone painful measures beyond their terms. While financial markets are far from perfect, they are arguably the most rational governance mechanism available to enforce budgetary discipline. Credit rating downgrades serve as useful *'wake-up calls'* and early warning mechanisms, facilitating discipline by markets by providing the

required information. Moreover, financial markets are useful for funding innovation, wealth preservation, risk-sharing and the like. Undermining the trust in financial markets may therefore lead to substantial welfare losses.

In the end, the question whether credit rating downgrades stimulate discipline and hence enhance governance or whether they lead to excessive distress losses is an empirical question that to the best of my knowledge has not been answered. Currently, I am setting up a research project that addresses this question in the U.S. corporate sector.

3.3. Assessment of sovereign rating regulations

Some of the regulations introduced in CRA3 can in my view be considered as window dressing. These include the ban on policy advice (easily circumvented) and the investigation of a public European CRA (very expensive and seems to violate independence requirements much more than issuer-paid). However, if such regulations restore trust in financial markets, those may be worthwhile considering, provided that costs are limited.

Other proposals regarding sovereign ratings may be more serious. In view of the large impact of sovereign ratings, sufficient effort and care should be warranted and to that end, regular reviews of sovereign rating procedures as carried out recently by ESMA are in my view beneficial. The articles to reduce over-reliance on credit ratings in general (as discussed in section 2) can also help to mitigate extreme distress resulting from downgrades.

The other proposals such as the rating calendar however may compromise budgetary discipline. Moreover, the rating calendar may undermine trust in markets. Sovereigns that expect rating downgrades may try to issue (unnecessary) large volumes just before the (predictable) downgrade and hence harm unsophisticated (primarily retail) investors. Lower trust in sovereign bond markets can increase average sovereign funding costs in the long run, which also disadvantages well behaving countries.

One may even think about strengthening the governance role of CRAs by stimulating them to review sovereign ratings more timely and to ignore bail-out mechanisms such as the ESM in their ratings. This would slightly increase sovereign funding costs, but reduce the probability of budgetary crises.

If one is concerned about disproportionate losses resulting from sovereign rating ceilings for corporates, specific regulation can be designed to address such issues.

3.3.1. Recommendations

Based on the above analysis, my main recommendations can be summarized as follows.

1. Reconsider the desirability of special treatment of sovereign ratings
2. Continue sovereign rating supervision to avoid misratings
3. Investigate ways to strengthen rather than deteriorate the contribution of ratings and credit markets to fiscal discipline
4. Withdraw rating calendar
5. Consider regulation relating to sovereign ceilings

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3. CONTRIBUTIONS BY THE SPEAKERS

3.1. Statement by Mr Franco DESTRO (IOSCO)

The statement made by Mr Destro can be found under the following link:

http://www.europarl.europa.eu/ep-live/en/committees/video?event=20140318-1230-COMMITTEE-ECON.

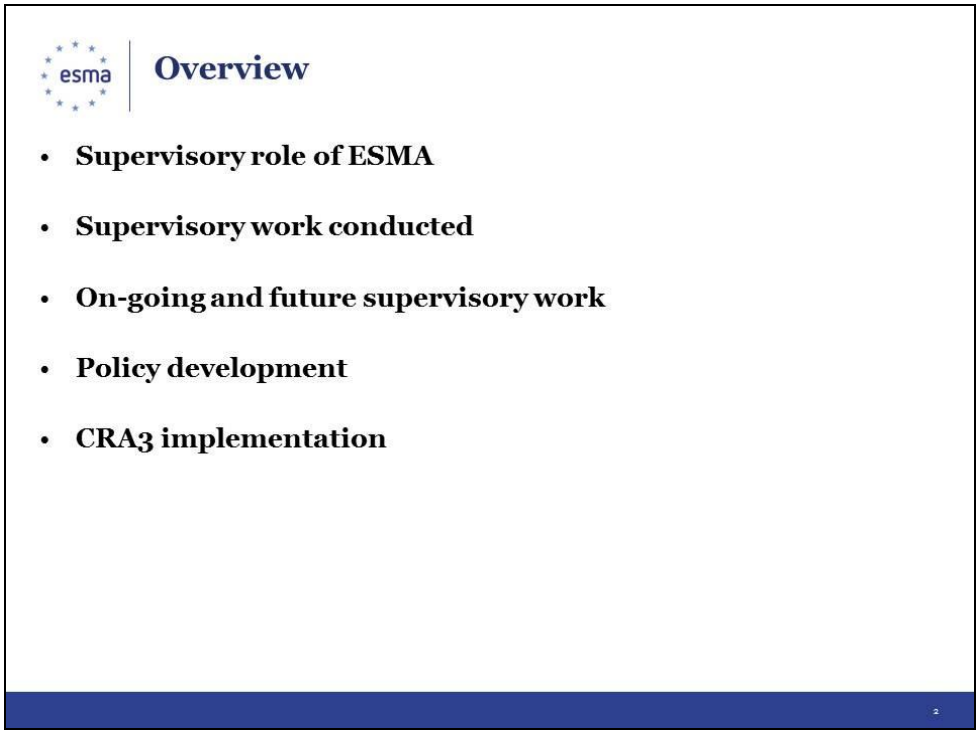
The remarks had been related to the *IOSCO Consultation Report on Code of Conduct Fundamentals for Credit Rating Agencies*: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD438.pdf.

3.2. Statement by Ms Grace SONE (FSB)

The statement made by Ms Sone can be found under the following link:

http://www.europarl.europa.eu/ep-live/en/committees/video?event=20140318-1230-COMMITTEE-ECON.

3.3. Presentation by Mr Felix FLINTERMAN (ESMA)



The Supervisory Role of ESMA

ESMA's Key CRA Supervisory Responsibilities

- Assessment of registration applications and perimeter activities
- Ongoing supervision of 22 registered CRAs and 2 certified CRAs
- Enforcement – Fines/supervisory measures
- Guidelines, Q&As and draft RTSs for implementation of CRA Regulation
- Equivalence and endorsement assessment
- Management of rating databases CEREP (public) and Socrat (ESMA only)
- Cooperation with third country supervisors

3

Supervisory work conducted

- **2011 ->2013: Various investigations**

➢ Thematic investigation into transparency of methodologies and internal control functions

➢ Investigations into ratings publication controls and governance and control functions of individual CRAs

➢ Thematic investigation into bank rating methodologies

➢ Thematic investigation into the sovereign rating process

- **While there has been some progress in CRA's practices, deficiencies in certain areas have been observed**

4

On-going and future supervisory work

Investigations in 2014

- Thematic investigation into monitoring of structured finance ratings
- Thematic investigation into the validation of rating methodologies
- Thematic investigation of small and medium-sized CRAs
- Investigations into key elements of the rating process and IT systems and controls of individual CRAs

Risk analysis

- Enhancement of risk function through analysis of CRA business models and strategies supports risk-based supervision

5

Policy Development

- **Draft RTS on European Rating Platform, Fees and Structured finance instruments**
- **Q&As on CRA 3 Implementation**
  - ➢ First set of Q&A published on 17 December 2013
- **List of registered CRAs and their market share**
  - ➢ List indicating CRAs' 2012 market share published on 16 December 2013
- **Technical advice on the feasibility of a network of small and medium sized CRAs**
  - ➢ Report published on 21 November 2013
- **Reducing Reliance on Ratings**
  - ➢ Final report on removal of mechanistic references to reliance on ratings in ESAs guidelines published on 6 February 2014

6

Policy Development

Further requirements of CRA 3 Implementation

- Technical advice to the EC on appropriateness of European sovereign credit worthiness assessment
- Report on mapping of ratings scales of CRAs to enable greater cross comparison between ratings
- Renewing ESMA's assessments on 3rd-country endorsement
- Guidelines on alternatives to external credit ratings in creditworthiness assessments in order to enable reduction of reliance on ratings
- Development and adoption of the three draft RTS

7

CRA3 implementation – Draft RTS

European Ratings Platform

ESMA shall establish a platform, to be called the European Ratings Platform, which will offer:

- Free access to up-to-date rating information on a central website for investors, issuers and other interested parties

Objectives

- Possibility for investors to easily compare all credit ratings that exist with regard to a specific rated entity/ instrument
- Increase visibility for smaller and newer CRAs
- The platform will incorporate also the existing historical performance data (CEREP)

8

CRA3 implementation – Draft RTS

Fees charged by CRAs to their clients

ESMA shall specify the information content & format CRAs have to provide on fees charged to their clients.

Fees (pricing policies and procedures) should be:

- Non-discriminatory
- Based on actual cost
- Non-dependent on the results or outcome of the work performed

Objectives:

- Mitigate conflicts of interest
- Facilitate fair competition in the credit rating market

9

CRA3 implementation – Draft RTS

Structured finance instruments disclosure requirements

ESMA shall specify and disclose the underlying loan-level information sponsors/issuers/originators have to disclose regarding SFIs.

- Creating a standardized reporting template for loan-level data and other relevant information
- Setting up a public website for disclosure

Objectives

- Improve ability of investors to make informed assessment of creditworthiness of SFI
- Reduce investors' dependence on ratings
- Reinforce competition between CRAs

10


esma
European Securities and
Markets Authority
Thank you

3.4. Presentation by Mr Dion BONGAERTS (RSM, ERASMUS University, Rotterdam, Netherlands)

ROTTERDAM SCHOOL OF MANAGEMENT
ERASMUS UNIVERSITY

An economic analysis of credit rating markets and regulation

Dr. Dion Bongaerts
Rotterdam School of Management,
Erasmus University

The business school that thinks
and lives in the future

RSM Erasmus University

PROFILE

- Associate professor Rotterdam School of Management
  - 9 years research experience on credit markets and CRAs
  - Several grants from ECB and National Science Foundation for CRA research
  - Published in top academic journals
- Experience as risk management quant at ABN-AMRO
- Contact me anytime at: dbongaerts@rsm.nl

RSM Erasmus University

PURPOSE

- Question: Is the CRA3 legislation sufficient to prevent rating failures?
- Recommendations going forward
- I address two types of rating failures
  1. Rating inflation (e.g. structured products before 2007)
  2. Crisis exacerbation of sovereign downgrades

1. RATING INFLATION

- Backdrop
- Economic framework
  - Discipline by reputation
  - Reputation failure only in presence of external influences
  - Differs by asset class

1.1 RATING INFLATION

- Reputation works under following condition:
- *Cost savings now ≤ reputational value to be lost*
- Use this framework to evaluate incentive effects
  - Existing and new regulation
- Also assess practical feasibility

1.2 RATING INFLATION

- *Cost savings now* ≤ *reputational value*
- CRA3 regulation strengthening reputational value:
  - Transparency → higher probability of getting caught
  - Competition → more credible punishment threat
- CRA3 regulation weakening reputational value:
  - Everything → administrative costs ↑ → margin ↓
  - Competition → rating shopping ↑ and fees ↓

1.3 RATING INFLATION

- Recommendations

1. Tailor regulation to specific products
2. More research on stimulating competition and rotation
3. Add automatic punishment to civil liability
4. Develop contingency plan for over-reliance
5. Require CRAs annual account disclosure
6. Reduce product complexity

2. SOVEREIGN RATINGS

- Backdrop

- Economic framework
  - Trade-off: distress costs vs budgetary discipline
  - Additional effects on investor confidence

- Under-researched topic (project in progress)

2.1 SOVEREIGN RATINGS

- Distress costs vs budgetary discipline and confidence
- CRA3 reducing distress costs
  - Regulatory reviews / procedures (avoid accidental misratings)
  - Reduce regulatory reliance (lower effect on funding costs)
- CRA3 reducing budgetary discipline and confidence
  - Ratings calendar (risk of high issuance before downgrade)
  - Reduce regulatory reliance (lower sense of urgency)

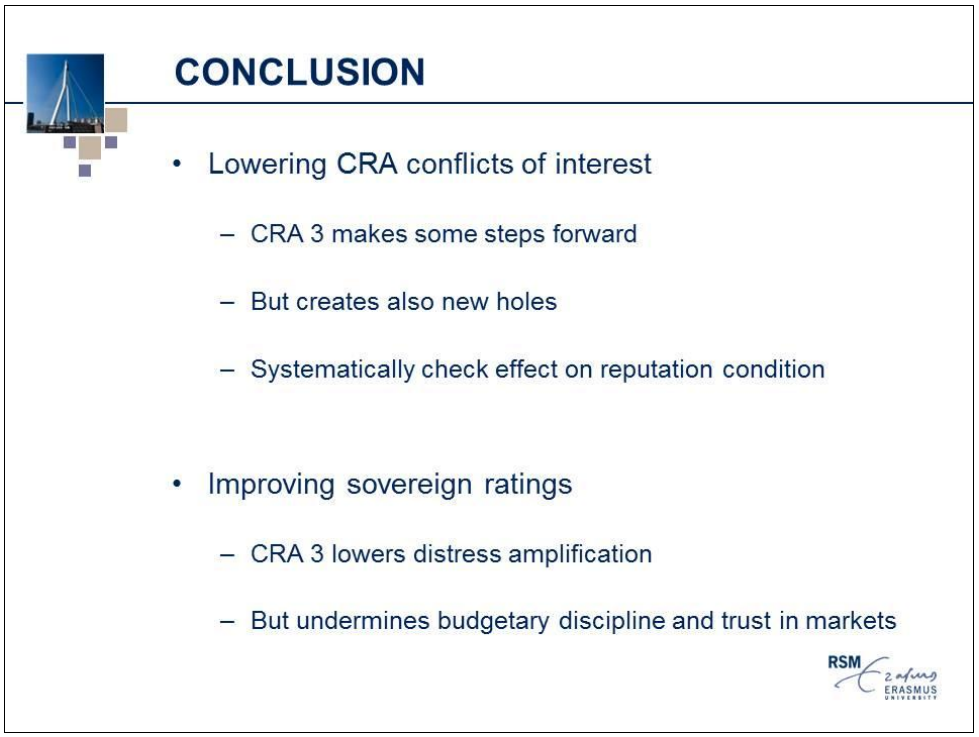
RSM Erasmus Rating

2.2 SOVEREIGN RATINGS

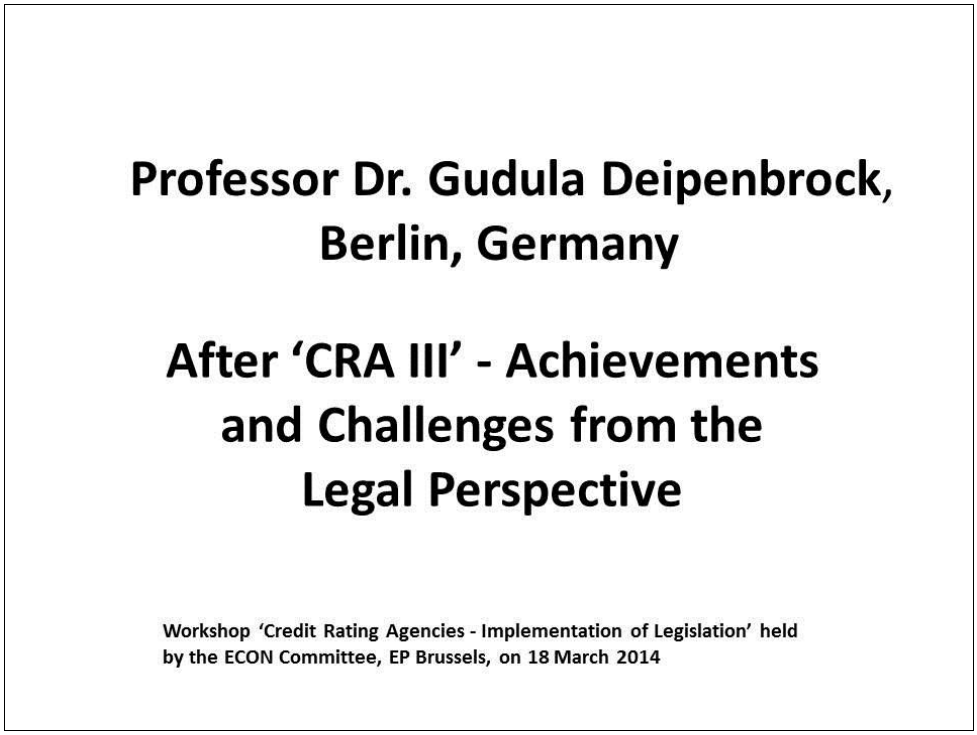
- Recommendations

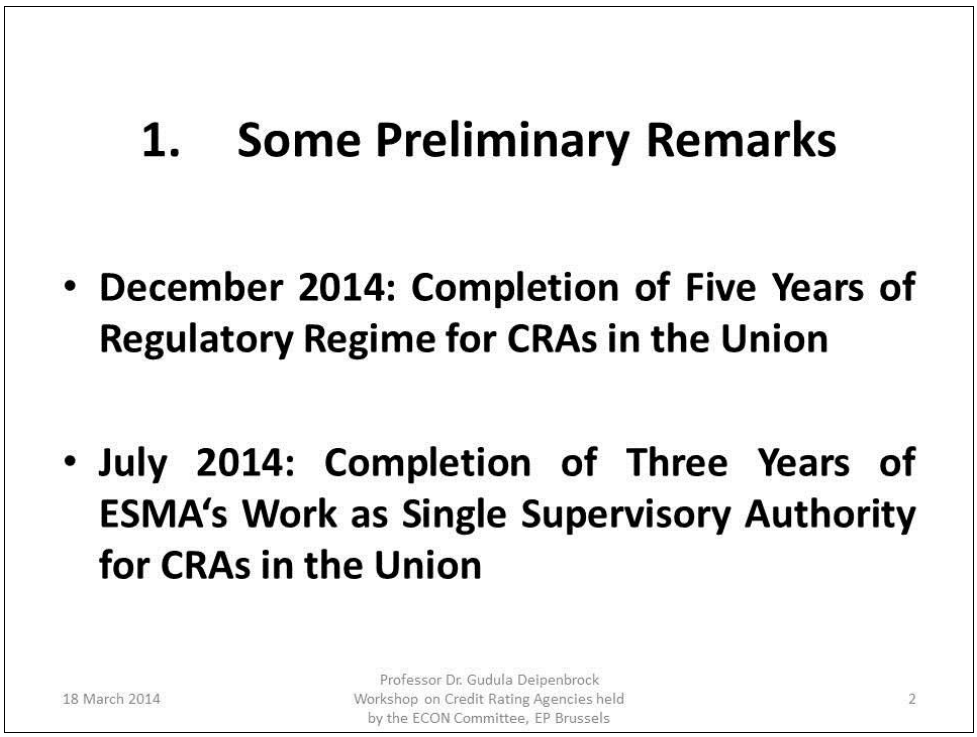
1. Reconsider special sovereign rating treatment
2. Consider using ratings to strengthen budgetary discipline
3. Withdraw rating calendar
4. Continue sovereign rating supervision
5. Consider regulation relating to sovereign ceilings

RSM Erasmus Rating


CONCLUSION
• Lowering CRA conflicts of interest
– CRA 3 makes some steps forward
– But creates also new holes
– Systematically check effect on reputation condition
• Improving sovereign ratings
– CRA 3 lowers distress amplification
– But undermines budgetary discipline and trust in markets
RSM
ERASMUS

3.5. Presentation by Ms Gudula DEIPENBROCK (HTW, Hochschule für Technik und Wirtschaft, Berlin, Germany)





2. Intended Goals of the Regulatory Regime for CRAs in the Union

- Avoidance of Conflicts of Interest
- Quality of Credit Ratings
- Transparency of Credit Rating Procedures
- Enhancement of Competition
- Civil Liability Regime for CRAs
- Quality of Sovereign Ratings
- Tackling Overreliance on Credit Ratings

3. Implementation and Application of the Regulation of CRAs in the Union Selected Rating-Directed Aspects

- The Registration Regime and the Material Requirements Regarding the Issuing of Credit Ratings
- Selected Other Instruments and Sanctions
- Miscellaneous

4. Implementation and Application of the Regulation of CRAs in the Union
Selected Rating-Based Aspects

The CRA III Regulation Addresses Overreliance on Credit Ratings

- **By Financial Institutions**
- **By the European Supervisory Authorities and the European Systemic Risk Board**
- **In Union Law**

5. Achievement of the Intended Goals and Challenges

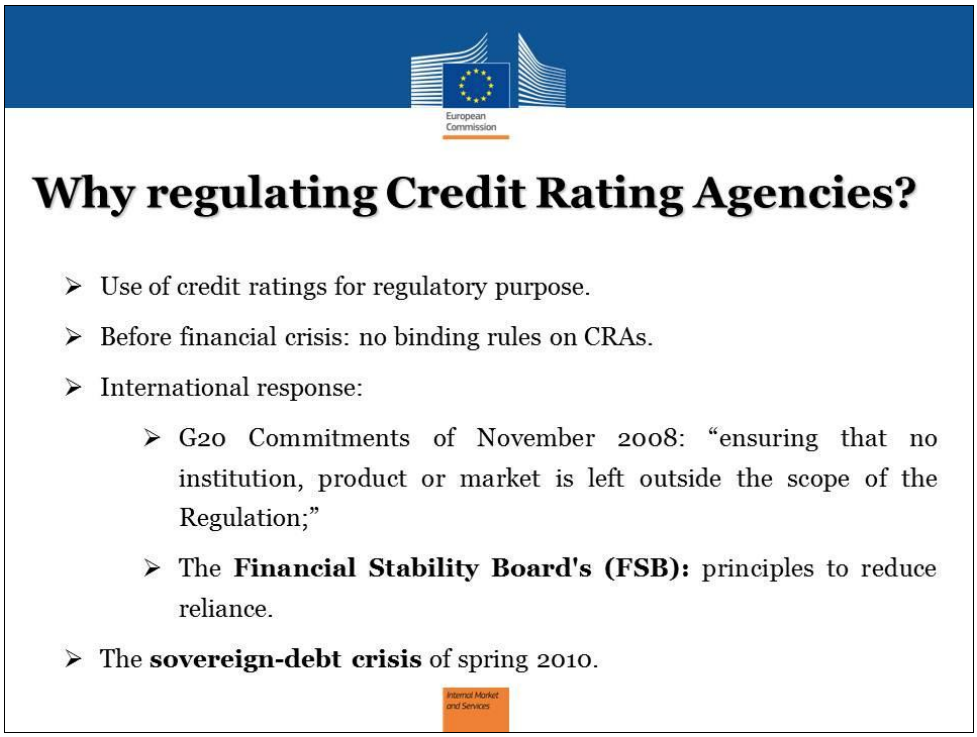
- **Regarding the Regulatory Regime: Achievements - 'Work in Progress' - Remaining Challenges - 'Wait and See'**
- **Regarding the Institutional Design and Regulatory Approach**
  - **Single Supervisory Authority Approach a Core Achievement**
  - **Tensions Between Goals: Emphasis Should Be on Tackling Overreliance on Credit Ratings**
  - **Risk of Overcomplexity**

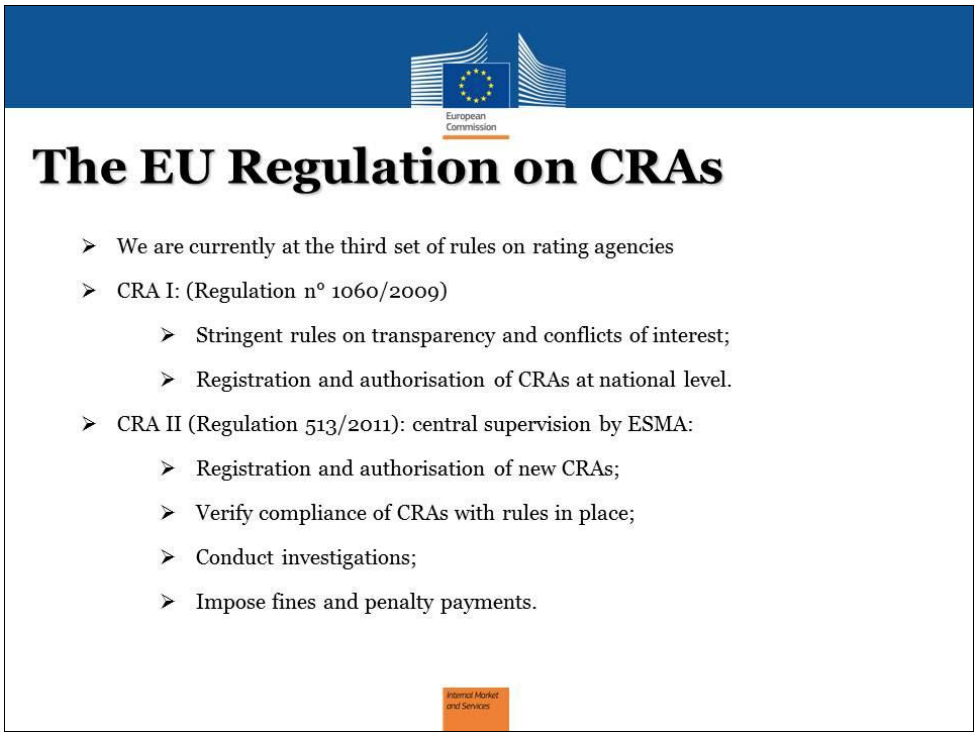
6. Possible Effects on the Credit Rating Sector and Other Financial Market Participants

- Registration Procedure Requires Balance Between 'Strict Gateway Approach' and Avoiding Market Entry Barriers
- Increasing Compliance of Registered CRAs with the Regulatory Regime

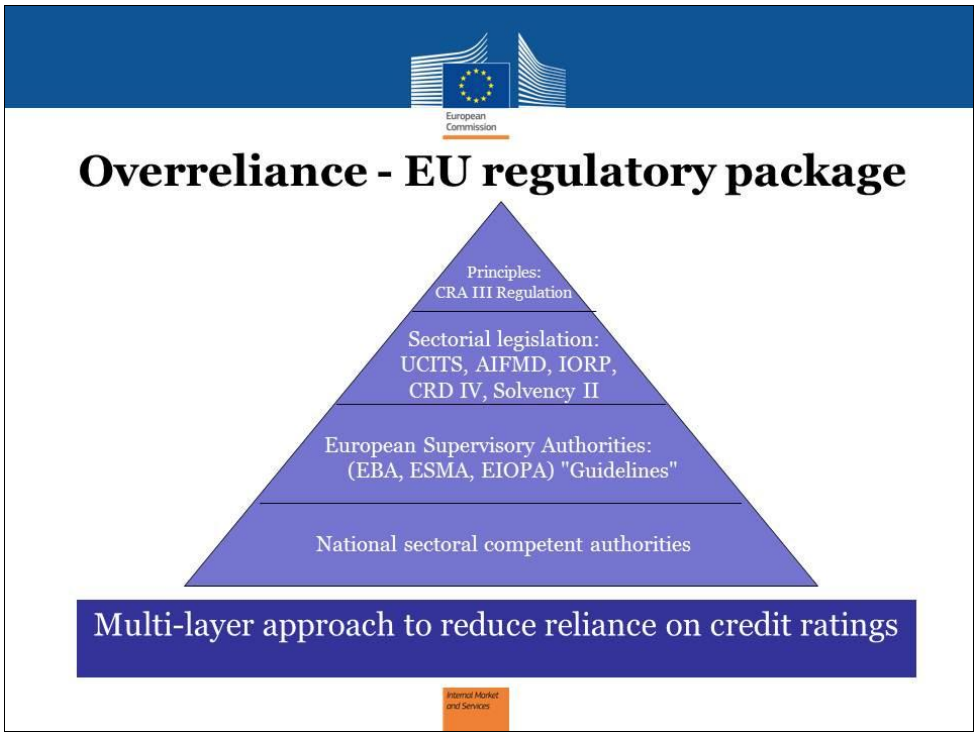
7. Conclusion and Outlook

3.6. Presentation by Mr Ugo BASSI (European Commission, DG Markt)

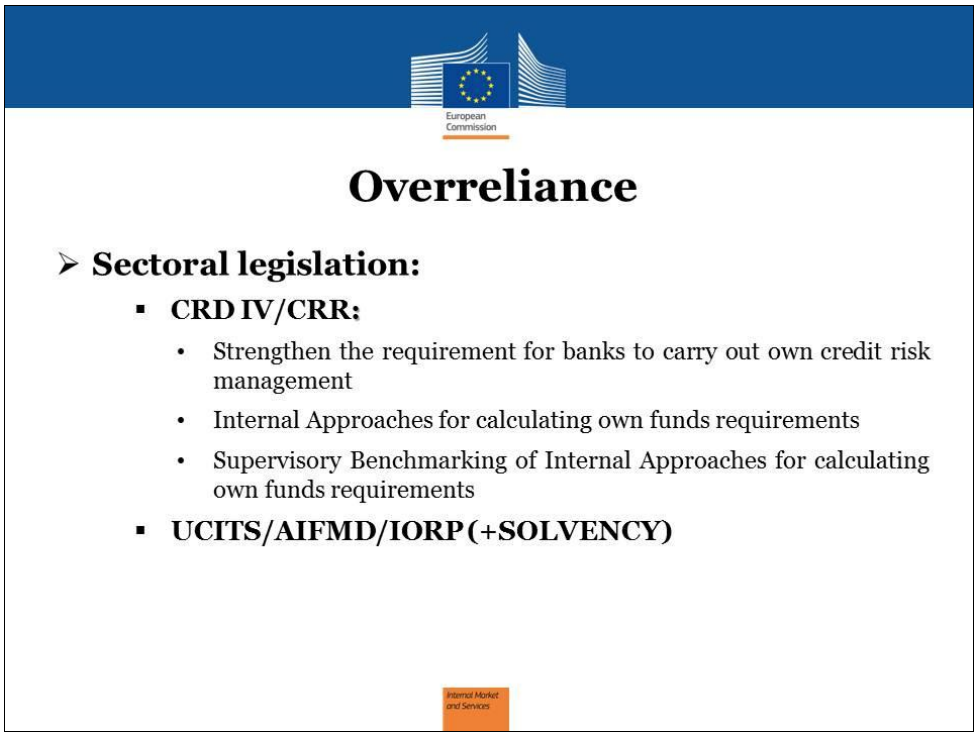

European Commission
Why regulating Credit Rating Agencies?
Use of credit ratings for regulatory purpose.
Before financial crisis: no binding rules on CRAs.
International response:
G20 Commitments of November 2008: "ensuring that no institution, product or market is left outside the scope of the Regulation;"
The Financial Stability Board's (FSB): principles to reduce reliance.
The sovereign-debt crisis of spring 2010.
Internal Market and Services

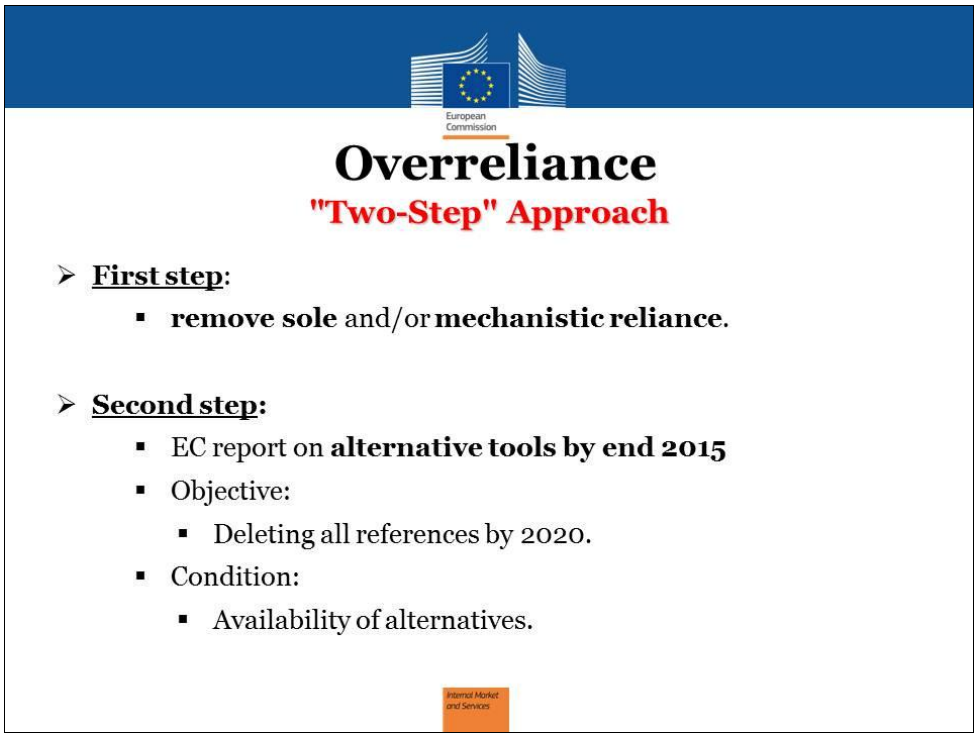

European Commission
The EU Regulation on CRAs
We are currently at the third set of rules on rating agencies
CRA I: (Regulation n° 1060/2009)
Stringent rules on transparency and conflicts of interest;
Registration and authorisation of CRAs at national level.
CRA II (Regulation 513/2011): central supervision by ESMA:
Registration and authorisation of new CRAs;
Verify compliance of CRAs with rules in place;
Conduct investigations;
Impose fines and penalty payments.
Internal Market and Services

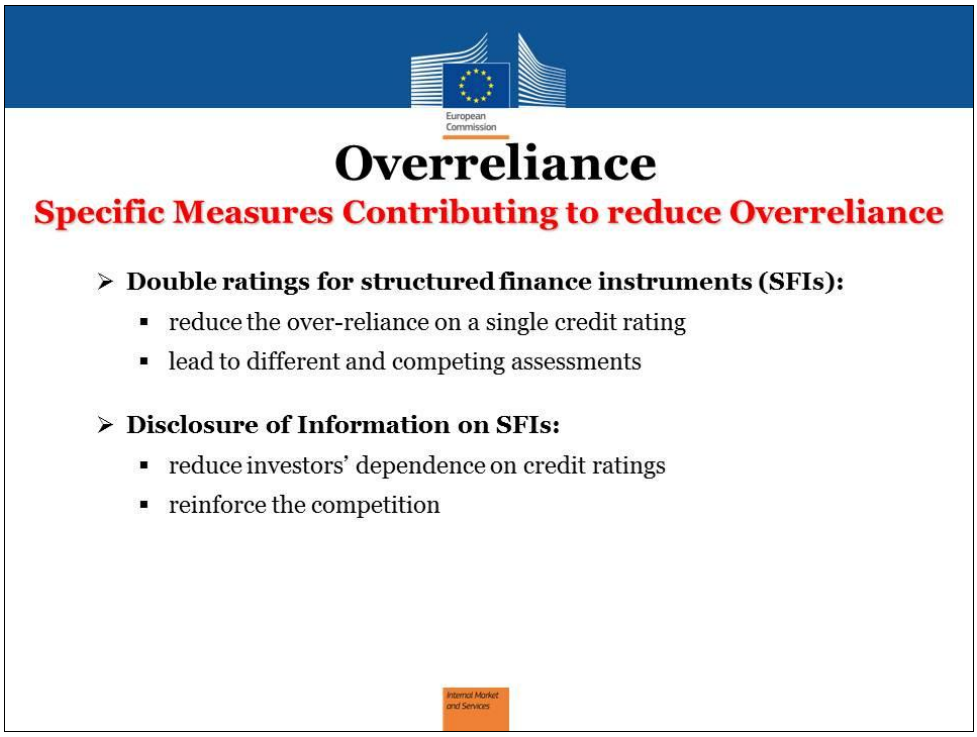

European Commission
Third set of rules on rating agencies
Internal Market and Services

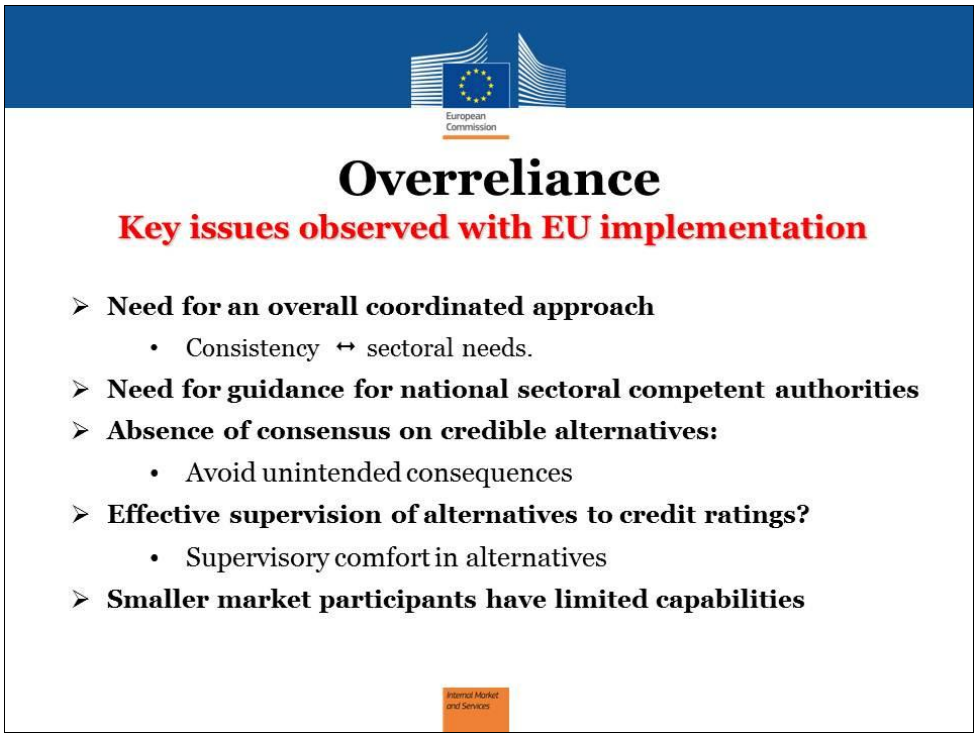

European Commission
Overreliance - EU regulatory package
Principles:
CRA III Regulation
Sectorial legislation:
UCITS, AIFMD, IORP,
CRD IV, Solvency II
European Supervisory Authorities:
(EBA, ESMA, EIOPA) "Guidelines"
National sectoral competent authorities
Multi-layer approach to reduce reliance on credit ratings
Internal Market and Services


European Commission
Overreliance
General Obligations for Financial Institutions
General Obligation for Financial Institutions:
Should not solely or mechanistically rely on credit ratings
Should strengthen their own credit risk assessment
Obligations for ESAs (ESMA , EBA and EIOPA) and Member States :
ESAs: to avoid/remove external ratings in their guidelines
ESMA: "Jumbo Guidelines" for sectorial and national competent authorities
MS: do not impose or maintain rules that allow stricter reliance by those investors on credit ratings
Internal Market and Services

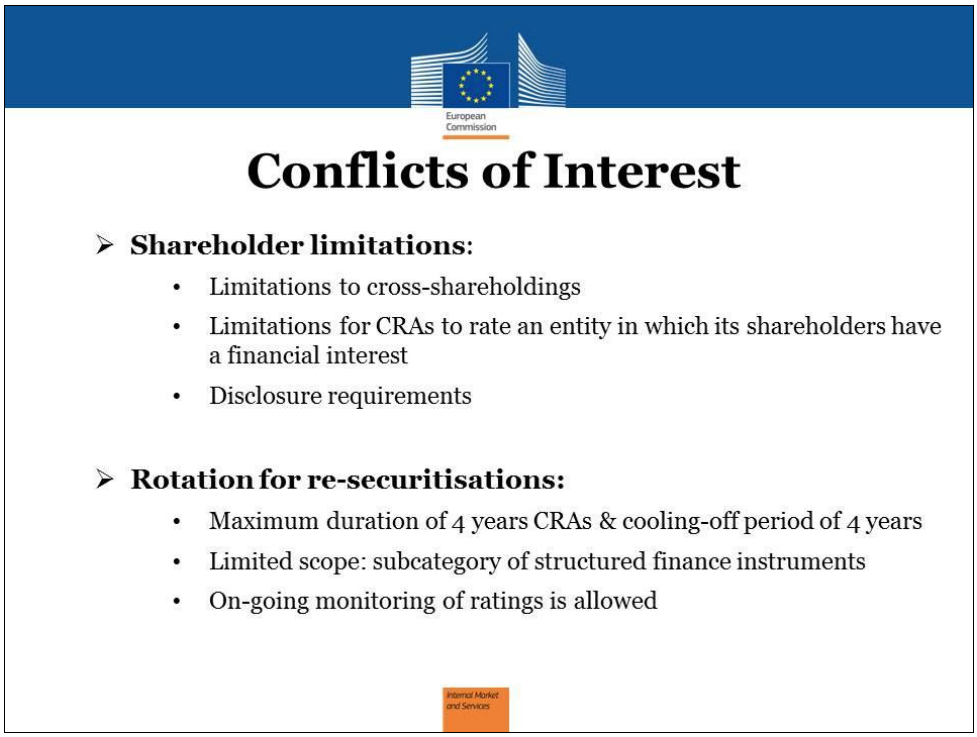

European Commission
Overreliance
Sectoral legislation:
CRD IV/CRR:
Strengthen the requirement for banks to carry out own credit risk management
Internal Approaches for calculating own funds requirements
Supervisory Benchmarking of Internal Approaches for calculating own funds requirements
UCITS/AIFMD/IORP (+SOLVENCY)
Internal Market and Services

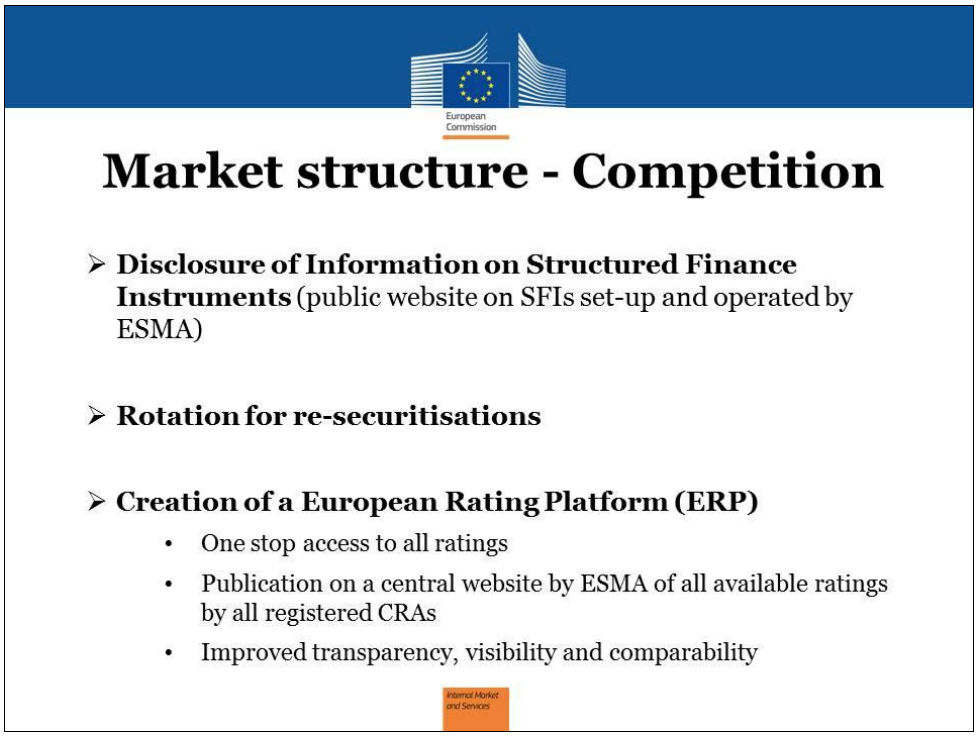

European Commission
Overreliance
"Two-Step" Approach
First step:
remove sole and/or mechanistic reliance.
Second step:
EC report on alternative tools by end 2015
Objective:
Deleting all references by 2020.
Condition:
Availability of alternatives.
Internal Market and Services

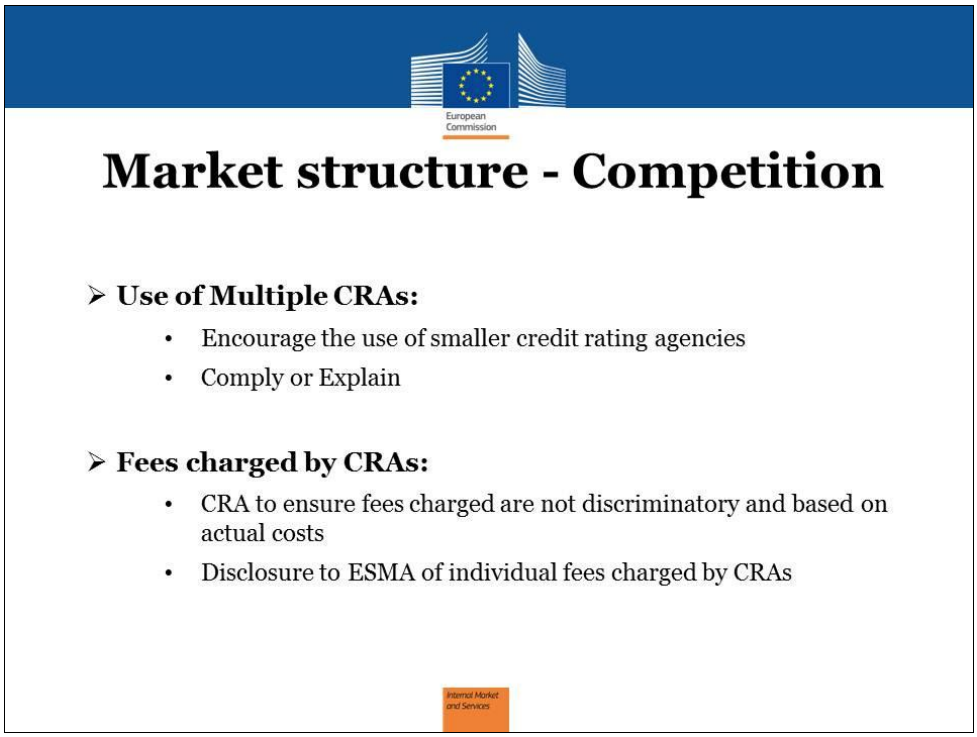

European Commission
Overreliance
Specific Measures Contributing to reduce Overreliance
Double ratings for structured finance instruments (SFIs):
reduce the over-reliance on a single credit rating
lead to different and competing assessments
Disclosure of Information on SFIs:
reduce investors' dependence on credit ratings
reinforce the competition
Internal Market and Services


European Commission
Overreliance
Key issues observed with EU implementation
Need for an overall coordinated approach
Consistency ↔ sectoral needs.
Need for guidance for national sectoral competent authorities
Absence of consensus on credible alternatives:
Avoid unintended consequences
Effective supervision of alternatives to credit ratings?
Supervisory comfort in alternatives
Smaller market participants have limited capabilities
Internal Market and Services


European Commission
Overreliance
Next steps in the EU?
A strong focus to reduce reliance on credit ratings remains:
Secondary legislation (Banking, Insurance, CCPs)
ESAs consultation paper
EBA: report bi-annually
Commission report by end 2015:
On alternatives to external credit ratings
With a view to removing all references by 2020
New legislative initiatives?
Internal Market and Services


European Commission
Conflicts of Interest
Shareholder limitations:
Limitations to cross-shareholdings
Limitations for CRAs to rate an entity in which its shareholders have a financial interest
Disclosure requirements
Rotation for re-securitisations:
Maximum duration of 4 years CRAs & cooling-off period of 4 years
Limited scope: subcategory of structured finance instruments
On-going monitoring of ratings is allowed
Internal Market and Services


European Commission
Market structure - Competition
Disclosure of Information on Structured Finance Instruments (public website on SFIs set-up and operated by ESMA)
Rotation for re-securitisations
Creation of a European Rating Platform (ERP)
One stop access to all ratings
Publication on a central website by ESMA of all available ratings by all registered CRAs
Improved transparency, visibility and comparability
Internal Market and Services


European Commission
Market structure - Competition
Use of Multiple CRAs:
Encourage the use of smaller credit rating agencies
Comply or Explain
Fees charged by CRAs:
CRA to ensure fees charged are not discriminatory and based on actual costs
Disclosure to ESMA of individual fees charged by CRAs
Internal Market and Services


European Commission
Procedures on methodologies and disclosure
Procedures on methodologies:
Better communication of changes in methodologies
Public consultation on changes of methodologies
Disclosure:
CRAs shall consult issuers by giving them a full working day to correct potential factual mistakes
Internal Market and Services


European Commission
Civil Liability
Main principles:
Where a CRA has committed, intentionally or with gross negligence an infringement listed in the CRA Regulation
Having an impact on a credit rating
Investors and issuers may claim damages from the CRA, for damages caused to them due to this infringement
Legal concepts/terms to be interpreted and definied in accordance with the applicable national law
Internal Market and Services


European Commission
Sovereign Debt Ratings
Calendar for publication – 12 months
Timing of publication - on Fridays, after close of business of EU trading venues
Number of Ratings – maximum 3 unsolicited ratings per year
Notification – full working day to correct potential factual mistakes
Detailed report - public
Public Communications – use of information
Deviations - only possible where necessary to comply with legal obligations, accompanied by a detailed explanation
Internal Market and Services


European Commission
Further questions:
MARKT-F4@ec.europa.eu
Internal Market and Services

4. CURRICULA VITAE OF THE SPEAKERS

Ugo BASSI

Ugo Bassi is Director of Capital and Companies in the European Commission's Internal Market DG (DG.MARKT.F). As a senior manager, he has now four units under his auspices, covering important files related to:

- The free movement of capital
- Corporate governance
- Anti-Money Laundering
- Accounting and financial reporting
- Audit
- Credit Rating Agencies

A lawyer by profession, Ugo Bassi has been working in DG Markt for eighteen years, prior to which he gained considerable experience as "Référendaire" in the Court of Justice. He has headed three different, units dealing with Internal Market: in the area of public procurement; asset management and securities. Many of the policies under his charge were in direct response to the financial crisis but he has also managed teams covering the more traditional internal market issues.

Dion BONGAERTS

Dion Bongaerts is an Associate Professor of Finance at Rotterdam School of Management (RSM), Erasmus University. He specializes in the behavior of credit rating agencies, the pricing of credit risky instruments, and the origins and effects of market illiquidity. His work has been presented at major conferences around the world, including the AFA, WFA, EFA and NBER meetings and published in top tier academic journals including the Journal of Finance. He has received several grants, including a Veni grant from the Dutch National Science Foundation (NWO) and a Lamfalussy Fellowship from the ECB. Dr. Bongaerts holds a PhD degree in Finance from the University of Amsterdam, an MSc in Econometrics from Maastricht University and has been a visiting scholar at Yale School of Management. Moreover, he has several years of professional experience as a risk management quant at ABN-AMRO bank.

Franco DESTRO

Mr. Destro is the U.S. Securities Exchange Commission International Counsel for the Office of Credit Ratings. Mr. Destro chairs the Supervisory Core College for Standard & Poor's. More recently he has been assisting the Chair of the FSB Peer Review Team on the Report on the Thematic Review on FSB Principles for Reducing Reliance on CRA Ratings. Mr. Destro represents the US SEC within IOSCO Committee 6. Mr. Destro holds a master degree in International Affairs from the Italian Ministry of Foreign Affairs and degrees in law from the University of Padova and from Columbia Law School in New York. He researched for his thesis at the University of Strasbourg III while he interned at European Parliament. Mr. Destro practiced law in New York for many years before joining the SEC in 2012.

Gudula DEIPENBROCK

Ms Deipenbrock is a professor of Business Law at the *Hochschule für Technik und Wirtschaft* (HTW) Berlin, University of Applied Sciences, Germany. She holds the degrees of 1st State Examination in Law (after law studies at University of Münster) and 2nd State Examination in Law as well as a PhD in Law (University of Münster). She is a member of the Editorial Board (continuous co-operation) of the law journal *Recht der Internationalen Wirtschaft* (RIW). She is a Consultant General Editor of the *International and Comparative Corporate Law Journal*. Before joining HTW Berlin in 1998, she was a corporate counsel and project manager in several German companies, especially large groups of companies, working particularly in the fields of international co-operation, mergers and acquisitions and National and International Business Law. Her research areas including manifold publications cover particularly National Business Law, International Business Law, Company Law, European Union Law, Foreign Business Law, Comparative Law and Capital Market Law. Her scholarship in company law and sustainability includes papers on sustainability rating and corporate sustainability from the perspective of German company law. Her scholarship in financial market regulation includes numerous papers on the various legal aspects of the credit rating industry.

Felix FLINTERMAN

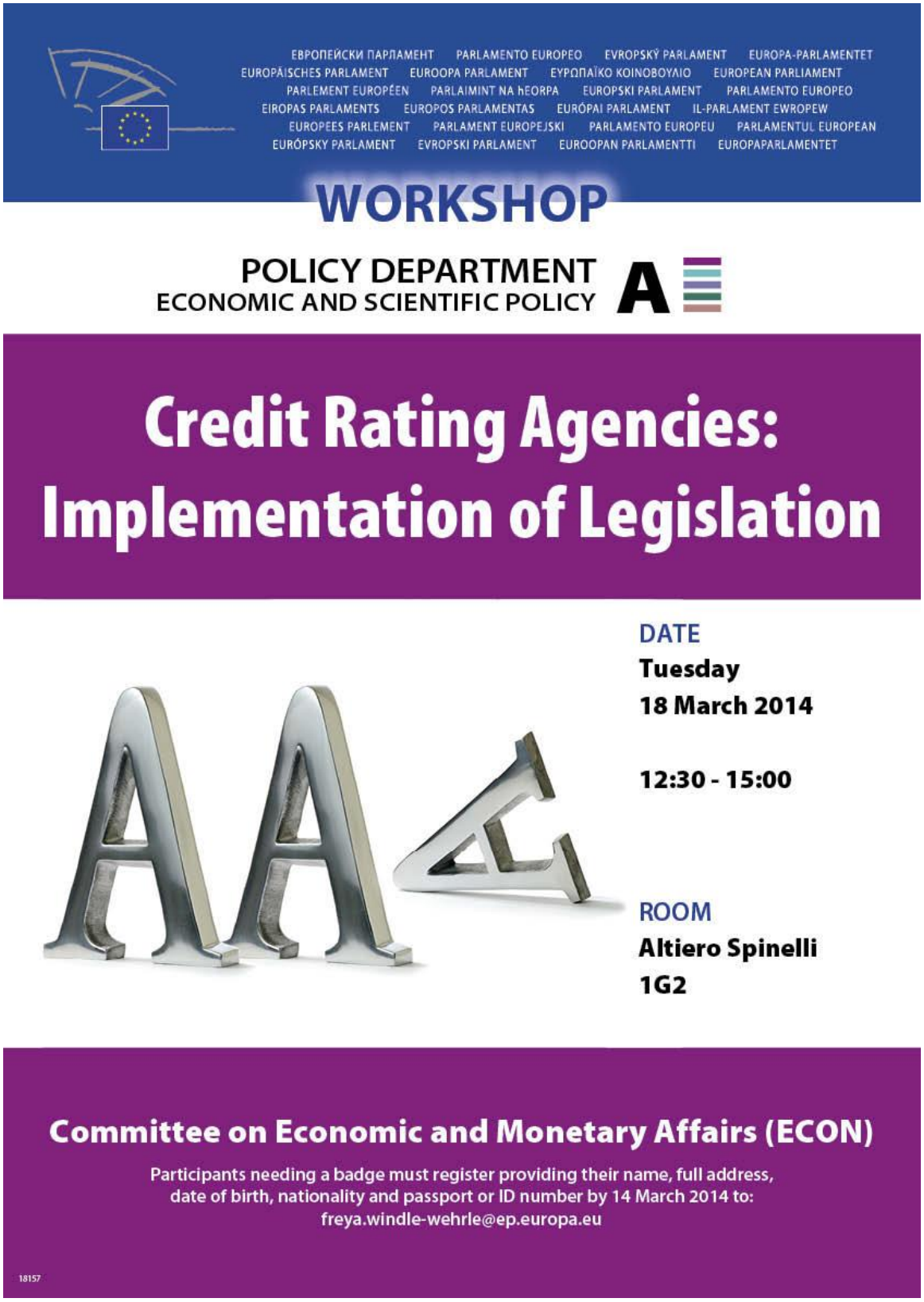
Felix Flinterman is the Head of the Credit Rating Agencies (CRA) Unit of the European Securities and Markets Authority (ESMA) since 1 October 2011. Before joining ESMA, he has been the manager of the capital markets team of the Netherland Authority for the Financial Markets' (AFM) policy department. Previously, he worked for the European Commission (DG Markt) and the Dutch Central Bank. He started his professional career at the international law firm Stibbe in Amsterdam. Felix Flinterman (born in 1973) is a qualified lawyer in the Netherlands with Master degrees from the University of Groningen and the University of Nottingham.

Grace SONE

Grace Sone joined the secretariat of the Financial Stability Board (FSB) in September 2010 and is on a leave of absence from the Federal Reserve Bank of New York (FRBNY). While at the FRBNY, she was co-Head of Supervisory and Regulatory Policy within Bank Supervision. Grace also spent a number of years in the FRBNY's Markets Group and served as the US Treasury representative in Korea during the Asian crisis. She has over a decade of private sector experience, having worked at State Street Bank as a global market strategist and at Freddie Mac as Head of Fixed Income Investor Relations. In her current role, she supports the FSB Standing Committee on Supervisory and Regulatory Cooperation, the FSB Supervisory Intensity and Effectiveness group and is involved in the FSB's work on consumer protection.

Ms Sone holds an MBA in finance and international business from the NYU Stern School of Business.

WORKSHOP POSTER



NOTES

EUROPEAN PARLIAMENT

CATALOGUE QA-01-14-261-EN-C

DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT A
ECONOMIC AND SCIENTIFIC POLICY

Role

Policy departments are research units that provide specialised advice to committees, inter-parliamentary delegations and other parliamentary bodies.

Policy Areas

- Economic and Monetary Affairs
- Employment and Social Affairs
- Environment, Public Health and Food Safety
- Industry, Research and Energy
- Internal Market and Consumer Protection

Documents

Visit the European Parliament website: **http://www.europarl.europa.eu/studies**

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Credit Rating Agencies: Implementation of Legislation