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**Credit Rating Agencies and European Financial Market
Supervision**

CREDIT RATING AGENCIES AND EUROPEAN FINANCIAL MARKET SUPERVISION

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Credit rating agencies have been a core concern in the reform of the global and European financial architecture prompted by the financial crisis. The European Regulation on Credit Rating Agencies (CRA Regulation) entered into force at the end of 2009. Activities of credit rating agencies and the issuance of ratings had previously not been regulated in most Member States of the European Union. The importance of rating activities in financial markets and their regulation is not disputed. The previous reluctance of legislators – national and European – to regulate and supervise the rating sector is difficult to justify. This became even clearer with the financial crisis and with the assessment of its causes. The supervision of credit rating agencies became a pressing issue with the CRA Regulation. The European Commission piloted, in parallel, a fundamental overhaul of financial supervision in Europe aiming at a more efficient, integrated and sustainable European system of supervision. The legal acts introducing the new European financial supervisory architecture build on the 2009 Report of the High Level Group of Experts (the de Larosière report) and came into force, recently. The new European system of supervision paved the way for making progress with a first reform of the CRA Regulation introducing a single European supervisory authority for credit rating agencies in the European Union. We take stock of the regulatory regime for credit rating agencies in its second year of application, and its – politically agreed – first reform.

A. Introduction

This article will analyse the legal aspects of the regulatory and supervisory framework for credit rating agencies (CRAs) in its second year of application, including its first reform, in the context of further reforms and against the backdrop of a new European architecture of financial market regulation that is currently unfolding. Focus will be on the control of rating activities in the European Union (EU) by means of regulatory and

supervisory law. Discussions on and the use of other instruments of control such as the civil liability regimes of national jurisdictions¹ – as this may apply to incorrect credit ratings (ratings) – have gained momentum.² The public consultation on CRAs of the European Commission (Commission) as of November 2010³ expressly puts forward the idea of introducing a civil liability regime in the CRA Regulation and asks for response from market participants, regulators and other stakeholders. Apart from the specific problems related to sovereign debt ratings in the context of the recent Euro debt crisis, the Commission's public consultation on CRAs furthermore addresses the issue of overreliance on external ratings⁴ which had negative effects on financial stability. The extensive reliance on ratings in the regulatory framework contributes to the problem.⁵ We have highlighted⁶ that overreliance on external ratings has to be reduced to tackle the risks of volatility in the market linked to rating activities. One can argue that as long as the actors in the financial markets are not willing to fulfil the ethical demands of the economic decisions they take,⁷ none of the controlling tools will be effective. Only if all instruments of behavioural control will be employed and allowed to interact in a balanced way – including responsibly acting players – they are likely to effectively respond to the major weaknesses of the rating market. CRAs are playing an influential role in global securities and banking markets.

¹ See Gudula Deipenbrock, *Externes Rating – „Heilsversprechen für internationale Finanzmärkte?“*, Betriebs – Berater (BB), vol. 36, 2003, 1849 et seq., 1851 et seq. See Andreas C. Peters, *Die Haftung und die Regulierung von Rating-Agenturen*, 2001, Baden-Baden, Nomos, 1st Edition. See Oliver v. Schweinitz, *Die Haftung von Ratingagenturen*, Wertpapier-Mitteilungen (WM), vol. 21, 2008, 953 et seq.

² *Abu Dhabi Commercial Bank v. Morgan Stanley & Co.*, 651 F. Supp. 2d 155, is an important recent judgment of the United States District Court (S. D. N. Y., 2 September 2009). See Brigitte Haar, *Haftung für fehlerhafte Ratings von Lehmann-Zertifikaten – Ein neuer Baustein für ein verbessertes Regulierungsdesign im Ratingsektor?*, Neue Zeitschrift für Gesellschaftsrecht (NZG), vol. 33, 2010, 1281 et seq., at 1281.

³ Commission, Directorate General Internal Market and Services, Public consultation on credit rating agencies, 5 November 2010, at p. 24.

⁴ For a recent US-American view on this, see Wall Street Journal, 29 – 31 October 2010, at p. 2. The request for a critical use of ratings has been voiced earlier (Richard Cantor, Frank Packer, *The credit rating industry*, FRBNY Quarterly Review, Summer-Fall 1994, 1 et seq., at 22). An educational case regarding reliance on external ratings and directors' duties was the ruling of the OLG Düsseldorf (*IKB*), 9 December 2009, available at BeckRS 2010, 00532 – beck-online.

⁵ For more information with further references, see Commission, Directorate General Internal Market and Services, Public consultation on credit rating agencies, 5 November 2010, at p. 5. For an in-depth analysis of the use of ratings for regulatory purposes, see Malte Richter, *Die Verwendung von Ratings zur Regulierung des Kapitalmarkts*, 2008, Frankfurt aM, Peter Lang.

⁶ Gudula Deipenbrock, Mads Andenas, Editorial, *Die erste Seite*, Recht der internationalen Wirtschaft (RIW), vol. 7, 2010, at 1.

⁷ Apart from (purely) unethical acts some disturbing developments within the capital markets such as the complexity of synthetic financial products, might lead to criminal behaviour. See Christian Schröder, *Die Komplexität synthetischer Finanzprodukte als Ursache für Vertrauensverluste und kriminogenes Verhalten am Kapitalmarkt*, Zeitschrift für Bankrecht und Bankwirtschaft (ZBB), vol. 4, 2010, 280 et seq.

CRAs are acting as information intermediaries⁸ and gatekeepers. Their ratings are used as opinion on creditworthiness by investors, borrowers, issuers and governments in order to take informed investment and financing decisions. Reducing the information asymmetry between the issuers of debt instruments and those investing in debt instruments has been a core function of ratings in the financial markets. Recital 1 of the CRA Regulation highlights that ratings may be used as the reference for the calculation of their capital requirements for solvency purposes or for calculating risks in their investment activity in particular by credit institutions, investment firms, insurance undertakings and institutions for occupational retirement provision. The impact ratings have had on the trust of investors and the proper functioning of the market cannot be overstated. Until 2009, CRAs have been subject to European Union law (Union law) only to a very limited extent. But long before the recent crisis international consensus had been achieved that instruments were in need to enhance the transparency and quality of rating procedures and ratings and to avoid or adequately manage conflicts of interest. International debate on appropriate regulatory tools for the rating industry first resulted in favouring a self-regulatory regime based on the Code of Conduct Fundamentals for CRAs of the International Organisation of Securities Commissions. It was the International Organisation of Securities Commissions (IOSCO)⁹ that developed soft law tools in the realm of securities regulation for governing CRAs' conduct. In September 2003, IOSCO's Technical Committee published a 'Statement of Principles Regarding the Activities of Credit Rating Agencies'¹⁰ (IOSCO Principles). The IOSCO Principles laid out high-level objectives, but left open the matters of implementation.¹¹ By the end of 2004, IOSCO developed a more specific and detailed code of conduct giving guidance on how the IOSCO Principles could be implemented in practice: the 'Code of Conduct Fundamentals'¹² (IOSCO Code Fundamentals).¹³ Due to the lack of law-making power of IOSCO, the IOSCO Code Fundamentals take the form of recommendations without legal binding force.¹⁴ They shall cover all types

⁸ For the economic concept of information intermediaries, see Andreas Horsch, *Rating und Regulierung*, 2008, Baden-Baden, Nomos, 1st Edition, at p. 89 et seq.

⁹ For the status, powers and organisation of IOSCO, see <http://www.iosco.org>.

¹⁰ For more information on this, see Gudula Deipenbrock, *Aktuelle Rechtsfragen zur Regulierung des Ratingwesens*, WM, vol. 6, 2005, 261 et seq., at 264 et seq.

¹¹ IOSCO, *Statement of principles regarding the activities of credit rating agencies*, September 2003, at introduction.

¹² IOSCO, *Code of conduct fundamentals for credit rating agencies*, December 2004. For more information on this, see Gudula Deipenbrock, *Was ihr wollt oder der Widerspenstigen Zähmung? – Aktuelle Entwicklungen der Regulierung von Ratingagenturen im Wertpapierbereich*, BB, vol. 39, 2005, 2085 et seq. See Gudula Deipenbrock, *Aktuelle Rechtsfragen zur Regulierung des Ratingwesens*, WM, vol. 6, 2005, 261 et seq., at 265 et seq.

¹³ IOSCO, *Code of conduct fundamentals for credit rating agencies*, December 2004, revised May 2008, introduction, at p. 2.

¹⁴ See Gudula Deipenbrock, *Was ihr wollt oder der Widerspenstigen Zähmung? – Aktuelle Entwicklungen der Regulierung von Ratingagenturen im Wertpapierbereich*, BB, vol. 39, 2005, 2085 et seq., at 2087.

of CRAs and mirror the common understanding of securities regulators across jurisdictions regarding standards for global CRA activities.¹⁵ The IOSCO Code Fundamentals are drafted in a general and abstract manner leaving much room for interpretation.¹⁶ IOSCO amended the IOSCO Code Fundamentals in May 2008, in the wake of the turmoil in the market for subprime mortgage-backed securities in 2007,¹⁷ addressing particularly the conflicts of interest and lacking transparency of ratings of structured finance instruments.¹⁸ After the first release of the IOSCO Code Fundamentals the EU adopted a respective self-regulatory regime in agreement with the main CRAs operating in the EU.¹⁹ The Committee of European Securities Regulators (CESR) – one of the three committees established in the framework of the *Lamfalussy*-procedure – oversaw the compliance with the IOSCO Code Fundamentals and delivered several annual reports on it.²⁰ During the voluntary compliance regime, CESR had consistently advocated market driven improvement and not the establishment of a mandatory regulatory regime.²¹

On 1 January 2011, the European Securities and Markets Authority (ESMA) replaced CESR.²² The replacement of CESR by ESMA marks a significant break between the initial regulatory regime for CRAs in the EU and the 'single European supervisory authority' approach taken by the Draft Amending Regulation. The fresh start of a new supervisory authority is likely to add to a speedy and successful implementation of the (draft) amendments to the regulatory regime. The following analysis will refer to CESR when elaborating on CESR's activities and the legal framework before 1 January 2011. ESMA will be discussed when depicting the legal framework after its establishment.

The impact of the IOSCO Code Fundamentals on the regulatory discussions has been undisputed. In practice its implementation by a self-regulatory regime failed. Reliance on self-regulatory mechanisms in the

¹⁵ IOSCO, A review of implementation of the IOSCO Code of conduct fundamentals for credit rating agencies, March 2009, at p. 3 et seq.

¹⁶ See Harry McVea, Credit rating agencies, the subprime mortgage debacle and global governance: the EU strikes back, *International and Comparative Law Quarterly* (ICLQ), vol. 59, 2010, 701 et seq., at 718.

¹⁷ See IOSCO, Media Release, IOSCO/MR/006/2008, 28 May 2008.

¹⁸ IOSCO, A review of implementation of the IOSCO Code of conduct fundamentals for credit rating agencies, March 2009, at p. 5.

¹⁹ See Gudula Deipenbrock, Der US-amerikanische Rechtsrahmen für das Ratingwesen – ein Modell für die europäische Regulierungsdebatte?, *WM*, vol. 48, 2007, 2217 et seq., at 2217.

²⁰ For more information on this with further references, see Gudula Deipenbrock, „Mehr Licht!“ – Der Vorschlag einer europäischen Verordnung über Ratingagenturen, *WM*, vol. 25, 2009, 1165 et seq., at 1166 et seq.

²¹ For more information on this with further references, see Gudula Deipenbrock, „Mehr Licht!“ – Der Vorschlag einer europäischen Verordnung über Ratingagenturen, *WM*, vol. 25, 2009, 1165 et seq., at 1167.

²² See *supra* A., at the end. See about the general background, Mads Andenas, *Harmonising and Regulating Financial Markets*, available at SSRN: <http://ssrn.com/abstract=1685971>.

rating industry turned out to be naïve. After the severe financial crisis peaking in the collapse of *Lehman Brothers* in autumn 2008 the European legislator left the self-regulatory model and introduced a European regulatory and supervisory framework for CRAs. Earlier, the US-American legislator had introduced a legal basis for a registration procedure of CRAs as Nationally Recognized Statistical Rating Organisations (NRSROs) by the Credit Rating Agency Reform Act of 2006,²³ which has been amended further²⁴ since then. The European Regulation on Credit Rating Agencies, Regulation (EC) No. 1060/2009²⁵ (CRA Regulation), has now been in force since December 2009. Other jurisdictions such as Australia and Japan have been introducing regulatory regimes for CRAs, recently too.²⁶ In parallel with the law-making procedure leading up to the adoption of the CRA Regulation, a fundamental overhaul of the European financial market supervisory architecture had been introduced based on the findings of the *de Larosière* report. The different legal acts establishing a European System of Financial Supervision (ESFS) have applied fully at least from 1 January 2011.²⁷ The ESFS is according to Recital 9 of the ESMA Regulation regarded as an integrated network of national and Union supervisory authorities, leaving day-to-day supervision to the national level. Apart from the establishment of a European Systemic Risk Board (ESRB),²⁸ three new European Supervisory Authorities (ESAs) have been established. The ESAs shall have legal personality and replace the respective former three level three committees established originally in connection with the *Lamfalussy*-procedure: CESR, the Committee of European Banking Supervisors and the Committee of European Insurance and Occupational Pensions Supervisors.²⁹ Recital 10 of the ESMA Regulation states that the

²³ For more information on this, see Gudula Deipenbrock, *Der US-amerikanische Rechtsrahmen für das Ratingwesen – ein Modell für die europäische Regulierungsdebatte?*, WM, vol. 48, 2007, 2217 et seq., at 2219 et seq.

²⁴ For more information on this, see Gudula Deipenbrock, *Das europäische Modell einer Regulierung von Ratingagenturen – aktuelle praxisrelevante Rechtsfragen und Entwicklungen*, RIW, vol. 9, 2010, 612 et seq., at 613. See Gerald Spindler, Kathrin Brandt, Julius Raapke, *Finanzmarktreform in den USA*, RIW, vol. 11, 2010, 746 et seq., at 751.

²⁵ Official Journal (OJ) EU L 302/1, 17 November 2009.

²⁶ See IOSCO, *Regulatory implementation of the Statement of principles regarding the activities of credit rating agencies*, Consultation report, May 2010, at p. 11.

²⁷ See Regulation (EU) No. 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ EU L 331/1, 15 December 2010, hereinafter referred to as ESRB Regulation; Regulation (EU) No. 1093/2010 establishing a European Supervisory Authority (European Banking Authority), OJ EU L 331/12, 15 December 2010, hereinafter referred to as EBA Regulation; Regulation (EU) No. 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), OJ EU L 331/48, 15 December 2010, hereinafter referred to as EIOPA Regulation; Regulation (EU) No. 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), OJ EU L 331/84, 15 December 2010, hereinafter referred to as ESMA Regulation.

²⁸ For an introduction to the ESRB, see Chryssa Papathanassiou, Georgios Zagouras, *Mehr Sicherheit für den Finanzsektor: der Europäische Ausschuss für Systemrisiken und die Rolle der EZB*, WM, vol. 34, 2010, 1584 et seq.

²⁹ See Recital 10 of the ESMA Regulation.

ESAs shall continue their respective work. A Joint Committee of the ESAs (Joint Committee) has been introduced by Art. 54 et seq. of the ESMA Regulation. It shall serve as a forum in which the ESAs shall cooperate regularly and ensure cross-sectoral consistency in specific areas. The status, powers and role of ESMA as the succeeding authority of CESR will be elaborated on further below.³⁰ Consequently, the Commission has proposed a reform of the CRA Regulation in June 2010 (Commission's Proposal on amending the CRA Regulation),³¹ establishing ESMA as the new centralised authority to supervise the CRAs in the internal market. Amendments were made to the Commission's Proposal on amending the CRA Regulation during the legislative procedure. Political agreement has been reached on the reform proposal in January 2011. This article will refer to the version of the draft regulation as adopted by the European Parliament (EP)³² in its first reading (Draft Amending Regulation) – unless marked otherwise. The Draft Amending Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the EU. The response of market participants, regulators and other stakeholders to the Commission's public consultation on CRAs³³ as of November 2010 might result in further reforms to strengthen the EU regulatory framework for CRAs.

B. The paradigm shift in the European regulation of credit rating agencies

I. The legal framework for regulation

The CRA Regulation is structured in accordance with its four fundamental objectives. They might be distinguished in formal and material objectives.³⁴ The material objectives cover (1) the enhancement of the quality of ratings, (2) avoidance and/or adequate management of conflicts of interest, and (3) the transparency of the rating procedures. These objectives have been at the core of the international discussion on (self) regulatory regimes for CRAs from its very beginning.³⁵ The fourth formal objective

³⁰ See *supra* C.I.

³¹ Commission, Proposal for a regulation on amending Regulation (EC) No. 1060/2009 on credit rating agencies, COM (2010) 289 final, 2 June 2010.

³² EP: position, 1st reading or single reading, EP T7-0478/2010, 15 December 2010.

³³ Commission, Directorate General Internal Market and Services, Public consultation on credit rating agencies, 5 November 2010. For more information on organisational aspects of the regulation of CRAs from the perspective of German law, see Denise Bauer, *Ein Organisationsmodell zur Regulierung der Rating-Agenturen*, 2009, Baden-Baden, Nomos, 1st Edition.

³⁴ See Gudula Deipenbrock, „Mehr Licht!“? – Der Vorschlag einer europäischen Verordnung über Ratingagenturen, WM, vol. 25, 2009, 1165 et seq., at 1169.

³⁵ See the four objectives of the IOSCO Statement of principles regarding the activities of credit rating agencies, September 2003. For more information on this, see Gudula Deipenbrock, *Was ihr wollt oder der Widerspenstigen Zähmung? – Aktuelle Entwicklungen der Regulierung von Ratingagenturen im Wertpapierbereich*, BB, vol. 39, 2005, 2085 et seq.,

addresses the institutional aspects of introducing a respective regulatory and supervisory regime. CRAs issuing ratings in the EU are subject to registration. The registration shall function as the principal prerequisite for CRAs to issue ratings intended to be used for regulatory purposes in the EU. The CRA Regulation entered into force on 7 December 2009. As already mentioned, the Draft Amending Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the EU.

1. *A critical approach to some material aspects of the regulation*

CESR has viewed the CRA Regulation as a prescriptive and strict EU legal and supervisory framework for CRAs with an ex-ante approach.³⁶ The core material objectives of the CRA Regulation which focus primarily on the improvement of the quality of ratings shall be achieved by relying more on an ex-ante than ex-post supervision.³⁷ The core material requirements as to the issuing of ratings are laid down in Title II of the CRA Regulation. The disclosure obligations – either towards the regulator or the public – refer to information on ratings as well as CRAs and their activities.³⁸ The competent authorities decide on CRAs' registration on the basis of the information CRAs are required to disclose according to Art. 15 (1) and Annex II of the CRA Regulation in the registration procedure.³⁹ The information to be provided refers to the CRAs as well as to the ratings and rating procedures. It covers information on, for instance, CRAs' ownership structure, organisation, corporate governance, financial resources, staffing and subsidiaries. The rating-relevant information refers particularly to the procedures and methodologies used to issue and review ratings, policies and procedures to identify, manage and disclose any conflicts of interest, information regarding rating analysts, compensation and performance evaluation arrangements and services other than rating activities the CRAs intend to provide. The information to be provided

at 2086. See Gudula Deipenbrock, Aktuelle Rechtsfragen zur Regulierung des Ratingwesens, WM, vol. 6, 2005, 261 et seq., at 265.

³⁶ See CESR, Technical advice to the European Commission on the equivalence between the US regulatory and supervisory framework and the EU regulatory regime for credit rating agencies, CESR/10-332, 21 April 2010, at no. 23 and no. 238.

³⁷ See CESR, Technical advice to the European Commission on the equivalence between the US regulatory and supervisory framework and the EU regulatory regime for credit rating agencies, CESR/10-332, 21 April 2010, at no. 238.

³⁸ For more information on the transparency regime in this context, see Brigitte Haar, Das deutsche Ausführungsgesetz zur EU-Rating-Verordnung – Zwischenetappe auf dem Weg zu einer europäischen Finanzmarktarchitektur, ZBB, vol. 3, 2010, 185 et seq., at 188 et seq.

³⁹ See CESR, Technical advice to the European Commission on the equivalence between the US regulatory and supervisory framework and the EU regulatory regime for credit rating agencies, CESR/10-332, 21 April 2010, at no. 238.

by CRAs in the registration process shall not be disclosed, afterwards.⁴⁰ Apart from the disclosure obligations of CRAs in connection with the registration application, Art. 8 (1), 10, 11 and 12 of the CRA Regulation oblige CRAs to disclose specific information to the public, to CESR or the competent authorities of the home Member States (MS). Information to be disclosed regarding ratings is particularly information on the rating methodologies, models and key rating assumptions, ratings and any decision to discontinue them. Section E Annex I of the CRA Regulation lists information to be disclosed in general and periodic disclosures and in the transparency report. It covers in particular actual and potential conflicts of interest, data about the historical default rates of its rating categories and detailed information on CRAs' legal structure, ownership and internal quality control mechanisms. The tight disclosure regime established by the CRA Regulation shall counter one of the pre-eminent flaws of the rating market: the lack of transparency.⁴¹ The Commission's public consultation on CRAs points out that further measures could be considered to strengthen transparency and quality, specifically for the rating of sovereign debt.⁴²

In addition to the disclosure requirements the CRA Regulation provides detailed obligations for CRAs in order to enhance the quality of their ratings and to adequately manage their conflicts of interest.⁴³ Art. 7 (1) of the CRA Regulation obliges CRAs to ensure that rating analysts have appropriate knowledge and experience for the duties assigned. Art. 8 (2) of the CRA Regulation requires CRAs to adopt, implement and enforce adequate measures to ensure that the ratings they issue are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis according to their rating methodologies. CRAs shall adopt all necessary measures in order to ensure that the information used for their ratings is of sufficient quality and from reliable sources. Under Art. 8 (3) of the CRA Regulation the methodologies used by CRAs shall be rigorous, systematic, continuous and subject to validation, based on historical experience, including testing based on historical data and review of previous ratings. CRAs shall monitor ratings and review their ratings and methodologies on an on-going basis and at least annually. The Draft Amending Regulation does not amend these core material requirements. This allows the addressees of the respective rules and

⁴⁰ See CESR, Technical advice to the European Commission on the equivalence between the US regulatory and supervisory framework and the EU regulatory regime for credit rating agencies, CESR/10-332, 21 April 2010, at no. 238.

⁴¹ See Gudula Deipenbrock, „Mehr Licht!“? – Der Vorschlag einer europäischen Verordnung über Ratingagenturen, WM, vol. 25, 2009, 1165 et seq., at 1172.

⁴² For more information on the ideas, see Commission, Directorate General Internal Market and Services, Public consultation on credit rating agencies, 5 November 2010, at p. 15 et seq.

⁴³ For more information on this, see Gudula Deipenbrock, Das europäische Modell einer Regulierung von Ratingagenturen – aktuelle praxisrelevante Rechtsfragen und Entwicklungen, RIW, vol. 9, 2010, 612 et seq., at 613 et seq.

the market so far to rely on and fully adapt to the regulatory regime as it has been introduced. It remains to be seen whether the results of the Commission's public consultation on CRAs will lead to further reforms regarding sovereign debt ratings⁴⁴ which have been discussed and where the crisis in the Euro zone has made states particularly aware of the problems of the rating process at the same time as they may as issuers have a direct interest leading to a conflict of interest as regulators.

Regarding the independence of CRAs and avoidance of conflicts of interest, the CRA Regulation provides far-reaching organisational as well as operational requirements to be fulfilled by CRAs.⁴⁵ But the CRA Regulation does not address the 'issuer-pays' model although it entails conflicts of interest by its nature. The inherent conflict of interests in this model is that CRAs are financially interested in increasing their revenues from the issuers that are to be rated. This might result in giving ratings that are too favourable. The European legislator had not proposed a legislative solution to this in the 2009 CRA Regulation or addressed it in any other way. The Commission's Proposal on amending the CRA Regulation addressed this problem for the first time by advocating a system similar to an instrument introduced by the US legislator.⁴⁶ Apart from the anticipated positive effects on the management of conflicts of interest and the competition in the rating market, the Commission took the view that the global rating market requires similar solutions in the various jurisdictions.⁴⁷ Under Art. 8a of the Commission's Proposal on amending the CRA Regulation,⁴⁸ the issuer of structured finance instruments or a related third party shall provide to the CRA it appoints access to all information necessary for the CRA to initially determine or monitor a rating of a structured finance instrument. Furthermore, if any other CRA registered or certified according to the CRA Regulation so request, it shall be granted access to the information referred to in Art 8a (1) under specific circumstances. The EP's Committee on Economic and Monetary Affairs amended the proposed provision by broadening its scope of application to issuers of all financial instruments and requiring ESMA to review the functioning of the article by 1 July 2014 and issue an opinion on which the Commission shall act, if appropriate.⁴⁹ However, the Draft Amending

⁴⁴ Commission, Directorate General Internal Market and Services, Public consultation on credit rating agencies, 5 November 2010, at p. 14 et seq.

⁴⁵ See Gudula Deipenbrock, *Das europäische Modell einer Regulierung von Ratingagenturen – aktuelle praxisrelevante Rechtsfragen und Entwicklungen*, RIW, vol. 9, 2010, 612 et seq., at 614.

⁴⁶ Commission, Proposal for a regulation on amending Regulation (EC) No. 1060/2009 on credit rating agencies, COM (2010) 289 final, 2 June 2010, at p. 6.

⁴⁷ Commission, Proposal for a regulation on amending Regulation (EC) No. 1060/2009 on credit rating agencies, COM (2010) 289 final, 2 June 2010, at p. 5 et seq.

⁴⁸ Commission, Proposal for a regulation on amending Regulation (EC) No. 1060/2009 on credit rating agencies, COM (2010) 289 final, 2 June 2010.

⁴⁹ EP, Committee on Economic and Monetary Affairs, Report on the proposal for a regulation on amending Regulation (EC) No. 1060/2009 on credit rating agencies, 25 November 2010,

Regulation no longer contains the proposed Art. 8a but instead provides a re-drafted Recital 5. Recital 5 of the Draft Amending Regulation now states that consideration shall be given on how best to extend the transparency of information underlying the ratings of all financial instruments. Recital 5 of the Draft Amending Regulation explains the fundamental objectives linked to the transparency of information given by the issuer of a rated financial instrument, and requires the Commission to analyse the appropriate scope of a new issuers' disclosure obligation (including disclosure to the whole market) and to put forward adequate legislative proposals in light of its assessment. Although the seeds of a second reform of the CRA Regulation have already been sowed here, the legislator's approach appears to be sensible. Any pre-mature introduction of a – not sufficiently thought through – issuers' disclosure obligation may have run contrary to the objectives that shall be achieved with it. The considered broadened scope of disclosure of issuer's information to the whole market appears to be a valuable contribution for further reform discussions. The Commission's public consultation on CRAs⁵⁰ – expressly referring to Art. 39 (1) of the CRA Regulation – covered the issues relating to conflicts of interest with respect to the 'issuer-pays' model, the high degree of concentration in the rating sector and the risk of overreliance on ratings by financial market participants.

The Draft Amending Regulation does not materially amend the provisions on the conflicts of interest of the CRA Regulation. Conflicts of interest remain a pressing issue and must be central to the review of the CRA Regulation and its operation.

2. *A critical approach to some institutional aspects*

The CRA Regulation introduced mandatory registration for CRAs operating in the EU as a precondition for the use of their ratings for regulatory purposes in the EU. The registration and supervision of CRAs operating in the EU form the institutional framework for the material requirements to be fulfilled by CRAs. Recitals 8 and 44 of the CRA Regulation make clear that the new regulatory regime does not interfere with the recommendation that CRAs should apply the IOSCO Code Fundamentals on a voluntary basis or the established process of recognising External Credit Assessment Institutions (ECAIs) in accordance with Directive 2006/48/EC.⁵¹ These have not been replaced by the CRA Regulation, but they apply in parallel. In the EU, recognised ECAIs

A7-0340/2010, at p. 12 and p. 15.

⁵⁰ Commission, Directorate General Internal Market and Services, Public consultation on credit rating agencies, 5 November 2010, at p. 3.

⁵¹ For extensive information on this, see Gudula Deipenbrock, *Ausgewählte Rechtsaspekte einer „Anerkennung“ von Ratingagenturen im Rahmen der Umsetzung der Basel II-Übereinkunft in europäisches Recht*, WM, vol. 48, 2006, 2237 et seq.

should apply for registration in accordance with the CRA Regulation. The requirement for registration is provided in Art. 14 (1) in conjunction with Art. 2 (1) of the CRA Regulation. Registered CRAs have to continue to fulfil the conditions for initial registration. All registration procedures in 2010 have been initiated under the institutional regime as introduced by the CRA Regulation, laid down particularly in its Title III. Under this regime CRAs have to submit their applications to CESR (now ESMA) under Art. 15 of the CRA Regulation and CESR is entitled to provide its advice to the home competent authorities on the completeness of the applications. The initially introduced institutional framework provides that the competent authorities of the home MS or the facilitator (in case of registration of a group of CRAs) and – in both cases – the competent authorities which are members of the relevant college shall examine the applications and the competent authorities of the home MS shall adopt fully reasoned registration or refusal decisions pursuant to Art. 16 or 17 of the CRA Regulation.⁵² Under the initially introduced institutional framework, in Art. 24 or 25 of the CRA Regulation, all supervisory powers lie with the competent authorities of the (home) MS. According to Art. 21 of the CRA Regulation CESR – as an advisory body – issued guidance on various supervisory subjects.⁵³ The complexity of the cooperation regime between competent authorities of the MS and CESR established by the CRA Regulation⁵⁴ has been attributable to the European institutional framework at the time of adopting the legal act and the dynamics of the crisis.⁵⁵ The crisis required the design of a new regulatory and supervisory framework for CRAs at short notice. Any legislative decision taken in this realm affects the division of powers between the supervisory authorities of the MS and those at EU level – a material and permanent bone of contention within the EU. At that time, neither the legal framework at EU level was considered sufficient for the introduction of a single European supervisory authority nor a common political will and agreement on it could be forged.⁵⁶

⁵² See Gudula Deipenbrock, *Das europäische Modell einer Regulierung von Ratingagenturen – aktuelle praxisrelevante Rechtsfragen und Entwicklungen*, RIW, vol. 9, 2010, 612 et seq., at 616.

⁵³ For more information on the issued guidance instruments, see supra B.II. For more information on the legal effects of CESR's recommendations in German capital market law, see Jan Hupka, *Kapitalmarktaufsicht im Wandel – Rechtswirkungen der Empfehlungen des Committee of European Securities Regulators (CESR) im deutschen Kapitalmarktrecht*, WM, vol. 29, 2009, 1351 et seq.

⁵⁴ See Thomas Möllers, *Auf dem Weg zu einer neuen europäischen Finanzmarktaufsichtsstruktur – Ein systematischer Vergleich der Rating-VO (EG) Nr. 1060/2009 mit der geplanten ESMA-VO*, NZG, vol. 8, 2010, 285 et seq., at 286 et seq.

⁵⁵ For an in-depth analysis of the problems of harmonisation and regulation of the European internal financial market, Mads Andenas, *Harmonising and Regulating Financial Markets*, available at SSRN: <http://ssrn.com/abstract=1685971>.

⁵⁶ See Gudula Deipenbrock, *Das europäische Modell einer Regulierung von Ratingagenturen – aktuelle praxisrelevante Rechtsfragen und Entwicklungen*, RIW, vol. 9, 2010, 612 et seq., at 616.

The complex international structures of the rating market required the European legislator to supplement the registration regime under the CRA Regulation by an endorsement and certification regime. Art. 4 of the CRA Regulation provides rules on endorsing ratings from third country CRAs and Art. 5 of the CRA Regulation provides using them under the specific rules on equivalence and certification based on equivalence without a respective endorsement.⁵⁷

II. The implementation of the regulatory regime

In the course of 2010, the national legislators of the MS as well as CESR had to fulfil their obligations under the CRA Regulation. CRAs had to submit their applications for registration or were invited to submit their applications for certification. Due to the complexity of its implementation, the new regulatory regime – as this is true for the majority of regulatory instruments in other sectors of the financial markets – will take effect only with a remarkable delay. Any assessment of the appropriateness and efficiency of the CRA Regulation's regime is thus possible several years after its adoption.⁵⁸ Apart from the changes made to the supervisory regime by the Draft Amending Regulation the outcome of the Commission's public consultation on CRAs⁵⁹ will probably result in further reforms. In addition, ESMA is mandated by the Draft Amending Regulation to transform large portions of the present guidelines issued by CESR into regulatory technical standards.⁶⁰ Against this backdrop, the reform element might turn into a permanent feature of the regulatory regime for CRAs. This may further delay its effects and pose a challenge for its evaluation.

1. EU coordination and supervision at the level of Member States

Member States had to designate their respective competent authorities by 7 June 2010 and adequately staff them. In addition, MS had to adopt national rules on penalties applicable to infringements of the CRA Regulation. In Germany⁶¹ the *Ausführungsgesetz zur Verordnung*

⁵⁷ See Harry McVea, Credit rating agencies, the subprime mortgage debacle and global governance: the EU strikes back, ICLQ, vol. 59, 2010, 701 et seq., at 722 et seq.

⁵⁸ See Gudula Deipenbrock, Mads Andenas, Editorial, Die erste Seite, RIW, vol. 7, 2010, at 1.

⁵⁹ Commission, Directorate General Internal Market and Services, Public consultation on credit rating agencies, 5 November 2010, at p. 3.

⁶⁰ ESMA, Call for evidence on the criteria for endorsement (Art. 21 (2) (a) of the draft amended CRA Regulation), ESMA/2011/0005, 14 January 2011, at p. 3.

⁶¹ For more information on recent German reform discussions in the realm of financial market regulation (It was the topic of the Section Public and private business law, 68. Deutscher Juristentag, 2010), see Peter Kindler, Finanzkrise und Finanzmarktregulierung – Ein Zwischenruf zum 68. Deutschen Juristentag, Neue Juristische Wochenschrift (NJW), vol. 34, 2010, 2465 et seq.; see Peter Mühlert, Finanzmarktregulierung – Welche Regelungen empfehlen sich für den deutschen und europäischen Finanzsektor?, Juristenzeitung (JZ),

(EG) Nr. 1060/2009 (AusfG CRA Regulation) has been adopted.⁶² The German legislator amended the German Code on Trading in Securities (Wertpapierhandelsgesetz).⁶³ The German competent authority according to the CRA Regulation is the Bundesanstalt für Finanzdienstleistungsaufsicht (Bafin). The AusfG CRA Regulation inserted rules on the supervision of CRAs as the CRA Regulation left some room for manoeuvre regarding the supervisory instruments to be employed.⁶⁴ The AusfG CRA Regulation provides that compliance of CRAs with their obligations under the CRA Regulation have to be audited.⁶⁵ A catalogue of administrative offenses and fines inserted in the Wertpapierhandelsgesetz effectively supplement the German rules.⁶⁶ However, the national rules implementing the CRA Regulation will have to be amended or repealed in so far as they will contradict to the provisions of the Draft Amending Regulation after its enactment.⁶⁷

CESR had to discharge important co-ordination and advisory functions alongside its traditional role of promoting convergence through guidelines and recommendations.⁶⁸ It issued guidance and guidelines on a number of supervisory subjects during the course of 2010, amongst others particularly on the registration process⁶⁹ or the Central Repository⁷⁰ where CRAs shall make available information on their historical performance data.⁷¹ The

vol. 17, 2010, 834 et seq. For general information on the development of the German capital market law in 2009, see Martin Weber, *Die Entwicklung des Kapitalmarktrechts im Jahre 2009*, NJW, vol. 5, 2010, 274 et seq.

⁶² Ausführungsgesetz zur Verordnung (EG) Nr. 1060/2009 des Europäischen Parlaments und des Rates vom 16. September 2009 über Ratingagenturen, BGBl. I No. 32, 18 June 2010, 786 et seq.

⁶³ For more information on the AusfG CRA Regulation, see Gudula Deipenbrock, *Das europäische Modell einer Regulierung von Ratingagenturen – aktuelle praxisrelevante Rechtsfragen und Entwicklungen*, RIW, vol. 9, 2010, 612 et seq., at 616 et seq.

⁶⁴ See Gudula Deipenbrock, *Das europäische Modell einer Regulierung von Ratingagenturen – aktuelle praxisrelevante Rechtsfragen und Entwicklungen*, RIW, vol. 9, 2010, 612 et seq., at 617.

⁶⁵ See Brigitte Haar, *Das deutsche Ausführungsgesetz zur EU-Rating-Verordnung – Zwischenetappe auf dem Weg zu einer europäischen Finanzmarktarchitektur*, ZBB, vol. 3, 2010, 185 et seq., at 191.

⁶⁶ For more information on this, see Brigitte Haar, *Das deutsche Ausführungsgesetz zur EU-Rating-Verordnung – Zwischenetappe auf dem Weg zu einer europäischen Finanzmarktarchitektur*, ZBB, vol. 3, 2010, 185 et seq., at 192 et seq.

⁶⁷ For more information on the German legislator's view, see Deutscher Bundestag, BT-Drucks. 17/716, at p. 8.

⁶⁸ For detailed information on CESR's activities in 2010, see CESR, CESR Annual report according to Art. 21 of Regulation (EC) No. 1060/2009 on credit rating agencies, CESR/10-1424, 6 December 2010.

⁶⁹ CESR, CESR's Guidance on registration process, functioning of colleges, mediation protocol, information set out in Annex II, information set for the application for certification and for the assessment of CRAs' systemic importance, CESR/10-347, 4 June 2010.

⁷⁰ CESR, CESR's Guidelines for the implementation of the central repository, CESR/10-331, 4 June 2010.

⁷¹ See CESR, CESR Annual report according to Art. 21 of Regulation (EC) No. 1060/2009 on credit rating agencies, CESR/10-1424, 6 December 2010, at no. 8.

endorsement and certification regime established by the CRA Regulation⁷² required further activities by CESR. This endorsement and certification regime is an innovative but highly complex instrument designed to solve the structural problem that all regulatory and supervisory regimes have to face when supervising actors in global markets.⁷³ The supervisory and regulatory instruments only apply within their respective jurisdictions. This appears to be a pivotal obstacle to any implementation of the principle that 'Regulators should follow markets'.⁷⁴ CESR performed in particular analyses of third country regimes in order to support possible determinations of equivalence made by the Commission for the purposes of certification.⁷⁵ The Commission asked for respective technical advices on the equivalence with the EU regime of regulatory regimes for CRAs in Japan, USA, Canada and Australia.⁷⁶ CESR issued technical advices to the Commission concerning Japan⁷⁷ and USA.⁷⁸ Regarding the Japanese regulatory regime the Commission has already adopted an equivalence decision according to Art. 5 (6) of the CRA Regulation.⁷⁹ It remains to be seen whether the complex endorsement and certification regime of the CRA Regulation will tackle the dysfunctionality⁸⁰ and asymmetry⁸¹ of the international financial market supervisory structure having coped with it, formally speaking at least, within the EU. In CESR's view concerns remain relating to the applications submitted by groups of CRAs for the endorsement of ratings.⁸² Each group of CRAs has applied to endorse ratings from between twelve and nineteen CRAs established in different

⁷² See *supra* B.I.2., at the end.

⁷³ See Gudula Deipenbrock, *Das europäische Modell einer Regulierung von Ratingagenturen – aktuelle praxisrelevante Rechtsfragen und Entwicklungen*, RIW, vol. 9, 2010, 612 et seq., at 615.

⁷⁴ See Mads Andenas, in: Mads Andenas, Yannis Avgerinos, *Financial Markets in Europe: Towards a Single Regulator?*, 2003, London, The Hague, New York, Kluwer Law International, at p. xxiv.

⁷⁵ See CESR, CESR Annual report according to Art. 21 of Regulation (EC) No. 1060/2009 on credit rating agencies, CESR/10-1424, 6 December 2010, at no. 48.

⁷⁶ See CESR, CESR Annual report according to Art. 21 of Regulation (EC) No. 1060/2009 on credit rating agencies, CESR/10-1424, 6 December 2010, at no. 49.

⁷⁷ CESR, Technical advice to the European Commission on the equivalence between the Japanese regulatory and supervisory framework and the EU regulatory regime for credit rating agencies, CESR/10-333, 9 June 2010.

⁷⁸ See CESR, Technical advice to the European Commission on the equivalence between the US regulatory and supervisory framework and the EU regulatory regime for credit rating agencies, CESR/10-332, 21 April 2010.

⁷⁹ Commission, Decision on the recognition of the legal and supervisory framework of Japan as equivalent to the requirements of Regulation (EC) No. 1060/2009 on credit rating agencies, 28 September 2010, C (2010) 6418 final.

⁸⁰ For more information on the dysfunctional structure of the banking market, see Thomas Möllers, *Auf dem Weg zu einer neuen europäischen Finanzmarktaufsichtsstruktur – Ein systematischer Vergleich der Rating-VO (EG) Nr. 1060/2009 mit der geplanten ESMA-VO*, NZG, vol. 8, 2010, 285 et seq., at 289 et seq.

⁸¹ See Marco Lamandini, *When more is needed: The European Financial Supervisory Reform and its legal basis*, *European Company Law* 6, vol. 5, 2009, 197 et seq., at 197.

⁸² See CESR, CESR Annual report according to Art. 21 of Regulation (EC) No. 1060/2009 on credit rating agencies, CESR/10-1424, 6 December 2010, at no. 51 et seq.

countries and the endorsing CRAs of each group – mainly subsidiaries established in the United Kingdom – intend to import into the EU nearly all types of ratings.⁸³ In CESR's view the objective reasons underlying the decision to endorse ratings from third countries appears to be a crucial point.⁸⁴ Although the endorsement rules will not be changed by the Draft Amending Regulation, ESMA will have to reconsider the initial guidelines on endorsement where appropriate in light of new developments and experience.⁸⁵

2. Registration of credit rating agencies

CESR has received applications for registration or certification from forty-five legal entities in total in 2010; at the beginning of December 2010 only one individual CRA has been registered.⁸⁶ The registration process regarding the majority of applications submitted by CRAs during the summer of 2010 is still pending.⁸⁷ The application processes so far revealed some institutional problems regarding the functioning of the colleges of competent authorities. It turned out to be difficult to ensure the consistency in terms of analyses and conclusions across colleges.⁸⁸ In contrast to the colleges individual competent authorities appeared to have proceeded faster with assessing the applications regarding local CRAs; in CESR's view it might be difficult for the supervisors to apply the principle of proportionality⁸⁹ to individual local CRAs while fully respecting the overarching principles of the CRA Regulation.⁹⁰ As the flaws of the institutional system as mentioned are linked to the functioning of the colleges, they may be remedied by the Draft Amending Regulation introducing a single supervisory authority for CRAs. The transitional measures in Art. 40a of the Draft Amending Regulation provide that the powers and duties of the competent authorities and colleges in connection

⁸³ See CESR, CESR Annual report according to Art. 21 of Regulation (EC) No. 1060/2009 on credit rating agencies, CESR/10-1424, 6 December 2010, at no. 51.

⁸⁴ See CESR, CESR Annual report according to Art. 21 of Regulation (EC) No. 1060/2009 on credit rating agencies, CESR/10-1424, 6 December 2010, at no. 52.

⁸⁵ See ESMA, Call for evidence on the criteria for endorsement (Art. 21 (2) (a) of the draft amended CRA Regulation), ESMA/2011/0005, 14 January 2011, at no. 2.

⁸⁶ See CESR, CESR Annual report according to Art. 21 of Regulation (EC) No. 1060/2009 on credit rating agencies, CESR/10-1424, 6 December 2010, at no. 55.

⁸⁷ See CESR, CESR Annual report according to Art. 21 of Regulation (EC) No. 1060/2009 on credit rating agencies, CESR/10-1424, 6 December 2010, at no. 54.

⁸⁸ See CESR, CESR Annual report according to Art. 21 of Regulation (EC) No. 1060/2009 on credit rating agencies, CESR/10-1424, 6 December 2010, at no. 56.

⁸⁹ For more information on the principle of proportionality in context with the legislative procedure regarding the Draft Amending Regulation, see Commission, Commission Staff Working Document, Impact Assessment, SEC (2010) 678, 2 June 2010, at p. 11 et seq. For a comparative view on the principle of proportionality, see Mads Andenas, Stefan Zleptnig, Proportionality: WTO Law: in Comparative Perspective, *Texas International Law Journal*, vol. 42 no. 3, 2007, 371 et seq.

⁹⁰ See CESR, CESR Annual report according to Art. 21 of Regulation (EC) No. 1060/2009 on credit rating agencies, CESR/10-1424, 6 December 2010, at no. 57.

with the initial institutional framework under the CRA Regulation shall terminate by 1 July 2011. However, the competent authorities and colleges shall take the registration or refusal decision regarding the applications they received from CRAs by 7 September 2010.

C. Reform of the CRA Regulation – heralding a new era?

The fundamental overhaul of the European financial market supervisory architecture based on the findings of the *de Larosière* report went through the first stages of the legislative process in parallel with the CRA Regulation. The legal acts establishing the ESFS have applied fully at least from 1 January 2011. The three new ESAs have been established by regulations each providing their respective status and powers in general. ESMA shall have legal personality as well as administrative and financial autonomy.⁹¹ The fundamentals on the status, powers and role of ESMA as the succeeding authority of CESR are provided in the ESMA Regulation. The ESMA Regulation established the – so far – outstanding legal framework for introducing a new single supervisory authority for the oversight of CRAs in the EU by the Draft Amending Regulation. The ESMA Regulation conferred new – in contrast to CESR's tasks – competences and powers on ESMA. These new powers include particularly the ability to draft technical standards, new powers in resolving disagreements between national authorities, emergency powers and competences regarding monitoring systemic risk of cross border financial institutions. Specific tasks in other areas including supervisory tasks might be conferred on ESMA by other legislative acts of the EU. To allow all three ESAs to work effectively, amendments to existing financial services directives have been and are still necessary in order to define the precise scope of certain of ESAs' new powers. Apart from general amendments to existing directives in the financial services sector to adapt their operation to the framework of the new authorities, balanced ways of how the ESAs might settle disagreements between national supervisors had and have to be defined.⁹² Material changes were and are furthermore necessary to existing financial services directives in order to define appropriate areas in which ESAs might propose technical standards as an additional tool for supervisory convergence.⁹³ The exclusive power of ESMA regarding the registration and supervision of CRAs in the EU is conferred on it by the Draft Amending Regulation. The ESMA Regulation might be considered as the institutional backbone for any further conferral of powers to ESMA by other EU legal acts in the realm of sectoral regulation such as the Draft Amending Regulation together with the CRA Regulation. In ESMA's view, it is only in very limited circumstances, where the entity is pan-European and where there is a clear added value to EU-level supervision, that it is

⁹¹ See Recital 14 of the ESMA Regulation.

⁹² See Commission, IP/11/49, 19 January 2011, at p. 2.

⁹³ See Commission, IP/11/49, 19 January 2011, at p. 2.

likely that the European legislator will grant further supervisory powers to ESMA.⁹⁴

I. The role and powers of the new European regulator, ESMA

The pivotal amendment to the supervisory regime for CRAs to be introduced by the Draft Amending Regulation is the introduction of ESMA as the exclusively responsible authority for the registration and supervision of CRAs in the EU. This implies that the complex institutional structure introduced by the CRA Regulation distinguishing between home competent authorities and the other competent authorities as well as the use of supervisory coordination by colleges has become obsolete. The Draft Amending Regulation had to eliminate all provisions of the CRA Regulation envisaging a college type of supervisory coordination and ultimate, formal decision-making by a competent authority of the home MS.⁹⁵ The Draft Amending Regulation provides far-reaching amendments in particular to Title III of the CRA Regulation on the surveillance of rating activities and its Title IV on penalties, committee procedure, reporting, transitional and final provisions. ESMA will not be responsible for the oversight of the users of ratings. National competent authorities that were designated under the relevant sectoral legislation for the supervision of entities such as credit institutions, investment firms, insurance undertakings etc. remain responsible for the supervision of the use of ratings by those financial institutions and entities which are supervised at national level in the context and for the purpose of the application of other financial services directives, and for the use of ratings in prospectuses.⁹⁶ Art. 25a of the Draft Amending Regulation states that the sectoral competent authorities⁹⁷ shall be responsible for the supervision and enforcement of Art. 4 (1) of the CRA Regulation in accordance with the relevant sectoral legislation. The Draft Amending Regulation changes Art. 36 of the CRA Regulation and provides that MS shall lay down the rules on penalties applicable to infringements of Art. 4 (1) and shall take all measures necessary to ensure that they are implemented.

The centralised EU-level supervision of CRAs shall improve, streamline and simplify the registration procedure, and might reduce the time limits in its different stages.⁹⁸ The centralisation of EU-level supervision and the new competences of ESMA make the legislative goals more achievable.

⁹⁴ See ESMA, Frequently asked questions, ESMA/2011/009, 3 January 2011, at p. 9.

⁹⁵ See Commission, Proposal for a regulation on amending Regulation (EC) No. 1060/2009 on credit rating agencies, COM (2010) 289 final, 2 June 2010, at p. 6.

⁹⁶ See Recital 7 of the Draft Amending Regulation.

⁹⁷ See the definition in Art. 3 (1) of the CRA Regulation as amended by the Draft Amending Regulation.

⁹⁸ See Commission, Proposal for a regulation on amending Regulation (EC) No. 1060/2009 on credit rating agencies, COM (2010) 289 final, 2 June 2010, at p. 6.

The decisive new competence of ESMA is the ability to draft technical standards as instruments to achieve supervisory convergence. In the past CESR's powers regarding such instruments were limited to formulate technical advice for the Commission and standards and guidelines which were addressed to its members. None of these instruments had – at least not uncontroversially⁹⁹ – direct legal effects under the old regime. In contrast, ESMA's technical standards can be regarded as draft laws to be endorsed by the Commission. Under the regulations establishing the ESFS, the ESAs may develop draft technical standards in specific areas provided in the respective legislation which are to be submitted to the Commission for adoption in accordance with Art. 290 and 291 of the Treaty on the Functioning of the EU (TFEU) by means of delegated or implementing acts. The Commission will have to scrutinise that these draft technical standards are compliant with Union law and serve the EU interest and adopt them. In general, a first set of areas in which ESAs (ESMA) shall have power to develop technical standards which will be mandatory across the EU after their endorsement has been identified in the so-called Omnibus I¹⁰⁰ Directive¹⁰¹ for existing legislation including the Market Abuse Directive and the Transparency Directive. This first set of technical amendments to eleven directives came into force as part of the supervision package.¹⁰² A second set of amendments to the Solvency II Directive – the Omnibus II Directive – has been proposed by the Commission.¹⁰³ Already Recital 9 of the Omnibus I Directive stated that further areas for developing draft technical standards might be added to new legislative proposals.¹⁰⁴ Hence, Art. 21 (3) of the Draft Amending Regulation provides that ESMA shall submit draft regulatory technical standards for endorsement by the Commission regarding specific areas such as the information to be provided by a CRA in its application for registration as set out in Annex II of the CRA Regulation and the information that the CRA must provide for the application for certification and for the assessment of its systemic importance¹⁰⁵ to the financial stability or integrity of financial markets. ESMA's (and in general the ESAs') ability to propose draft technical standards is regarded as employing a tool for

⁹⁹ For more information on discussions about possible legal effects of CESR's recommendations, see Thomas Möllers, *Auf dem Weg zu einer neuen europäischen Finanzmarktaufsichtsstruktur – Ein systematischer Vergleich der Rating-VO (EG) Nr. 1060/2009 mit der geplanten ESMA-VO*, NZG, vol. 8, 2010, 285 et seq., at 286 and 288. See Jan Hupka, *Kapitalmarktaufsicht im Wandel – Rechtswirkungen der Empfehlungen des Committee of European Securities Regulators (CESR) im deutschen Kapitalmarktrecht*, WM, vol. 29, 2009, 1351 et seq.

¹⁰⁰ See e. g. ESMA, *Frequently asked questions*, ESMA/2011/009, 3 January 2011, at p. 5.

¹⁰¹ Directive 2010/78/EU, OJ EU L 331/120, 15 December 2010.

¹⁰² See Commission, IP/11/49, 19 January 2011, at p. 2.

¹⁰³ See Commission, at http://ec.europa.eu/internal_market/finances/committees/index_en.htm, date of access 27 January 2011.

¹⁰⁴ Directive 2010/78/EU, OJ EU L 331/120, 15 December 2010.

¹⁰⁵ For some fundamental ideas on systemic importance of financial institutions, see Marcus Günther, *Systemrelevanz von Finanzinstituten*, WM, vol. 18, 2010, 825 et seq.

supervisory convergence and with a view to developing a single rule book. This shall strengthen stability, and ensure equal treatment, lower compliance costs and prevent regulatory arbitrage.¹⁰⁶ The Commission's endorsement will turn the technical standards into ordinary secondary Union law.¹⁰⁷ The authors consider this a remarkable shift towards providing a single set of rules applicable to the EU rating market. ESMA is – like CESR was in general – also entitled to issue guidelines which will not be endorsed by the Commission. Art. 21 (2) and (2a) of the Draft Amending Regulation provide that ESMA shall issue and update guidelines particularly on the cooperation between ESMA, the competent authorities and the sectoral competent authorities for the purposes of the CRA Regulation and on the application of the endorsement regime under Art. 4 (3) of the CRA Regulation.¹⁰⁸ These rules are complemented by Art. 16 of the ESMA Regulation which provides not only that ESMA shall issue guidelines and recommendations addressed to competent authorities or financial market participants. It states that the competent authorities and the financial market participants shall make every effort to comply with these instruments. A comply or explain regime is set out in Art. 16 (3) of the ESMA Regulation which constitutes a key factor to further strengthen ESMA's effectiveness.¹⁰⁹ The overhaul of the institutional framework of the CRA Regulation by the Draft Amending Regulation requires transitional measures. According to Art. 40a of the Draft Amending Regulation all competences and duties related to the supervisory and enforcement activity in the field of CRAs and conferred on the competent authorities of MS and on colleges of competent authorities shall be terminated on 1 July 2011. Only the registration procedures initiated by CRAs by 7 September 2010 will be completed by the respective competent authorities and relevant colleges under the old institutional regime.

II. Further reform issues

One important reform element in the Commission's Proposal on amending the CRA Regulation,¹¹⁰ dealing with the material issue of conflicts of interest in connection with the 'issuer-pays' model, was eventually deleted in the Draft Amending Regulation. According to the newly re-drafted Recital 5 of the Draft Amending Regulation the Commission

¹⁰⁶ See Commission, IP/11/49, 19 January 2011, at p. 2.

¹⁰⁷ See Thomas Möllers, *Auf dem Weg zu einer neuen europäischen Finanzmarktaufsichtsstruktur – Ein systematischer Vergleich der Rating-VO (EG) Nr. 1060/2009 mit der geplanten ESMA-VO*, NZG, vol. 8, 2010, 285 et seq, at 289. For a comparative view on law-making powers of national financial supervisory authorities, see Patrick Halfpap, *Normsetzungsbefugnisse von Kapitalmarktaufsichtsbehörden*, Zeitschrift für Bank- und Kapitalmarktrecht (BKR), vol. 2, 2009, 65 et seq.

¹⁰⁸ See supra B.II.1., at the end.

¹⁰⁹ See ESMA, *Frequently asked questions*, ESMA/2011/009, 3 January 2011, at p. 5.

¹¹⁰ Commission, *Proposal for a regulation on amending Regulation (EC) No. 1060/2009 on credit rating agencies*, COM (2010) 289 final, 2 June 2010.

shall further analyse the appropriate scope of a new issuers' disclosure obligation and put forward adequate legislative proposals in light of its assessment. The outcome of the Commission's public consultation on CRAs¹¹¹ covering the issues related to conflicts of interest with respect to the 'issuer-pays' model, will clarify further the legislative approach. The provisions on the fundamental material aspects of the CRA Regulation concerning the substantive conditions to be fulfilled by CRAs which apply for registration or have been successfully registered as well as concerning the endorsement and certification regime under the CRA Regulation, have not been amended by the Draft Amending Regulation.

D. Conclusion

The supervisory and regulatory framework for CRAs in the EU will be subject to continued and anxious review. On the one hand there is the general principle that regulatory measures need a few years time to take effect and be assessed adequately. On the other hand, the regulatory architecture is developing fast. The Draft Amending Regulation's approach to introduce a single European supervisory authority for CRAs is in our view a sensible move towards efficient supervision in sectors of the EU financial market where the services delivered – as ratings – are not linked to a specific territory and are used by financial institutions all around the EU. The first practical experiences with the new regulatory regime may also provide the basis for assessing the efficiency in reducing conflicts of interest and in handling the registration issues. The regulation of CRAs will keep the attention of legislators, and keep financial markets and their participants in suspense, for some time to come.

¹¹¹ Commission, Directorate General Internal Market and Services, Public consultation on credit rating agencies, 5 November 2010, at p. 3.