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

2011/0361(COD) - 16/01/2013 - Text adopted by Parliament, 1st reading/single reading

The European Parliament adopted by 579 votes to 58, with 60 abstentions, a legislative resolution on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) No 1060/2009 on credit rating agencies.

Parliament adopted its position at first reading under the ordinary legislative procedure. The amendments adopted in plenary are the result of a compromise reached between the European parliament and the Council. They amend the proposal as follows:

Aim of the Regulation: the common regulatory approach shall aim to enhance the integrity, transparency, responsibility, good governance and **independence** of credit rating activities.

Using credit ratings for regulatory purposes: credit institutions, investment firms, insurance undertakings, reinsurance undertakings, institutions for occupational retirement provision, alternative investment funds and central counterparties as defined by EU legislation, may use credit ratings for regulatory purposes only if they are issued by credit rating agencies established in the Union and registered in accordance with this Regulation.

Excessive reliance on investment firms with regards to credit ratings: the Regulation stresses that overreliance on external credit ratings should be reduced and all the automatic effects deriving from ratings should be gradually eliminated. Credit institutions and investment firms should be encouraged to put in place internal procedures in order to make their own credit risk assessment and should encourage investors to perform a due diligence exercise.

Within this framework, this Regulation foresees that **financial institutions should not solely or mechanistically rely on ratings**. Therefore, those institutions should avoid entering into contracts where they solely or mechanistically rely on ratings and should avoid using external ratings in contracts as the only parameter to evaluate the creditworthiness of investments or decide whether to invest or divest.

Over-reliance on credit ratings in Union law: the Commission shall continue to review references to credit ratings in Union law which trigger or have the potential to trigger sole or mechanistic reliance on credit ratings by competent authorities or financial market participants, with a view to eliminating all references to ratings in Union law by 1 January 2020, provided that appropriate alternatives to credit risk assessment have been identified and implemented.

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

The amendments stipulate that the credit rating agency or any person holding, directly or indirectly, at least 5% of the capital or voting rights of the credit rating agency or otherwise in a position to influence significantly the business activities of the credit rating agency shall not hold 5% or more of the capital of

any other credit rating agency. This prohibition does not apply to holdings in diversified collective investment schemes, including managed funds such as pension funds or life insurance, provided that the holdings in diversified collective investment schemes do not put him or her in a position to exercise significant influence on the business activities of those schemes.

Maximum duration of the contractual relationship with a credit rating agency: the Regulation states that the market for re-securitisations is an appropriate place to first introduce rotation. This is the area of the European securitisations market that has underperformed since the financial crisis. The amended text stipulates that where a credit rating agency has entered into a contract for the issuing of credit ratings on re-securitisations, it shall issue no credit ratings on new re-securitisations with underlying assets from the same originator **for a period exceeding four years**. Where at least four credit rating agencies each rate more than 10% of the total number of outstanding rated re-securitisations, the limitations shall not apply.

As from the expiry of a contract, a credit rating agency shall not enter into a new contract for the issuing of credit ratings on re-securitisations with underlying assets from the same originator for a period equal to the duration of the expired contract but not exceeding four years.

Sovereign debt ratings: as requested by the Parliament, sovereign debt ratings shall be issued in a manner, which ensures that the individual specificity of a particular Member State has been analysed. **A statement announcing revision of a given group of countries shall be prohibited**, if not accompanied by individual country reports.

Where a credit rating agency issues sovereign ratings or related rating outlooks, it shall publish these ratings after the close of business hours of regulated markets and at least one hour before their opening.

On the same basis, it is also proportionate that at the **end of December, credit rating agencies should publish a calendar for the next 12 month**s setting the dates for the publication of sovereign ratings and corresponding to these, the dates for the publication of related outlooks where applicable. Such dates should be set on a Friday. Only for unsolicited sovereign credit ratings the number of publications in the calendar should be limited between two and three.

Double credit rating of structured finance instruments: where an issuer or its related third party intends to solicit a credit rating of a structured finance instrument, it shall mandate at least two credit rating agencies to provide credit ratings **independently of each other**.

An issuer or its related third parties shall ensure that the mandated credit rating agencies comply with the following conditions. In particular, (a) the credit rating agencies must not belong to the same group of credit rating agencies; (b) none of the credit rating agencies must be a shareholder or member of any of the other credit rating agencies.

Use of multiple credit rating agencies: where an issuer or a related third party intends to mandate at least two credit rating agencies for the credit rating of the same issuance or entity, the issuer shall consider the **possibility to mandate at least one credit rating agency which does not have more than 10% of the total market share** and which can be evaluated by the issuer as capable for rating the relevant issuance or entity, provided that, based on the list of ESMA, there is a credit rating agency available for rating the specific issuance or entity. With a view to facilitating the evaluation by the issuer, ESMA shall annually publish on its website a list of registered credit rating agencies, indicating their total market share and the types of ratings issued.

Disclosure of credit ratings: until disclosure to the market of credit ratings, rating outlooks and information relating to them, they shall be considered inside information as defined in Directive 2003/6 /EC.

Where a credit rating agency issues an **unsolicited credit rating**, it shall state prominently in the credit rating and using a clearly distinguishable different **colour code** for the rating category, whether or not the rated entity or related third party participated in the credit rating process and whether the credit rating agency had access to the accounts, management and other relevant internal documents for the rated entity or a related third party.

Civil liability: the investor or issuer claiming damages for an infringement of the rules in Regulation (EC) No 1060/2009 should present **accurate and detailed information** indicating that the credit rating agency has committed such an infringement of this Regulation. This should be assessed by the competent court, taking into consideration that the investor or issuer may not have access to information that is purely within the sphere of the credit rating agency.

Reporting: the Commission shall, following technical advice from ESMA, review the situation in the credit rating market for structured finance instruments, in particular the credit rating market for re-securitisations. By 1 July 2016, following that review, the Commission shall send a report to the European Parliament and to the Council, accompanied by a legislative proposal if appropriate.

By 1 January 2016, the Commission shall review the situation in the credit rating market. Following that review, the Commission shall submit a report, accompanied by a legislative proposal if appropriate.

The Commission shall submit:

- by 31 December 2015, a report with a view to **eliminating all references to credit ratings in Union law by 1 January 2020**, subject to appropriate alternatives being identified and implemented;
- by 31 December 2014, a report on the appropriateness of the **development of a European creditworthiness assessment for sovereign debt**;
- by 31 December 2016, a report on the appropriateness and feasiblity of **establishing a European credit rating agency** dedicated to assessing the creditworthiness of Member States' sovereign debt and/or a European credit rating foundation for all other ratings;
- by 31 December 2013, a report regarding the **feasibility of a network of smaller credit rating agencies** in order to increase competition in the market.

ESMA shall publish an annual report on the application of this Regulation.