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Layout & Distribution: Valéria Kozakova

# Credit Rating Agencies - Regulatory approach by the European Commission

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## Credit Rating Agencies

- State of play: overview of the regulatory framework for CRAs
- Subprime turmoil: concerns, reactions, initiatives
- Way forward

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## Regulatory framework for CRAs

### CRAs in EU:

- Commission Communication of 2006
- IOSCO code of conduct for CRAs of 2004.
- MAD. Exemption in recital 10 of Commission Directive 2003/125/EC
- Basel II: Capital Requirements Directive
- CESR monitoring role

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## Regulatory framework for CRAs

- CRAs in USA: is that a model? Main aspects of the Act on CRAs
  - In force since June 2007
  - Voluntary registration as NRSRO
  - SEC has supervisory powers
  - Requirements for register: in business 3 years, ratings certified by 10 institutional buyers
  - Content of the application for registration:
    - Statistics for measure the performance of the ratings
    - Rating procedures and methodologies
    - Care in use of inside information
    - Organisational structure
    - Code of ethics

The SEC can check whether CRA has adequate financial and managerial resources to consistently produce credit ratings with integrity, but does not go into the substance of the ratings or the procedures by which CRAs determine their ratings.

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## Regulatory framework for CRAs

- Other initiatives:
  - Japan
    - CRAs are used as ECAI (for Basel II) and as Designated Credit Assessment Institution (DCAI) for investor protection purposes under the Law on Sales of Financial Products (Japanese version of MiFID).
    - Criteria to become a DCAI: objectivity, independence, transparency, disclosure, resources and credibility
    - conflict of interests and abuse of undisclosed information are controlled.
    - FSA can examine rating records, personnel structure, organization, rating method, capital composition and neutrality from issuers
    - status of DCAI needs to be renewed once a year
  - France: annual reports from AMF

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## Subprime crisis

- Reactions: ECOFIN, London meeting, ECB, EP, IOSCO, FSF
- Concerns:
  - potential conflicts of interest: “issuer pays” model, consultancy services, involvement in the structuring of products...
  - transparency of ratings/methodologies: assumptions, criteria reviews, reasons for a downgrade, labelling...
  - quality of ratings: accuracy of the information, enough resources, training...
- Initiatives of CRAs: amendment of IOSCO code

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## Way forward

- The Commission is assessing the role and practices of CRAs, assisted by CESR and ESME
- Report from CESR
  - To be delivered in may.
  - Checking the changes in CRAs codes of conduct
  - Consultation period starting the 12 February.
  - Main findings about transparency, human resources, conflicts of interest, monitoring of ratings and methodology
  - Regulation or self regulation?
- The report from ESME will provide the practitioners view. Due to April

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## Way forward

Commissioner McCreevy,

- Last Wednesday: *"In relation to credit rating agencies, (...) **things cannot remain as they are** (...) there is **more to be done**. (...) if proposals in this regard that are meaningful and robust are not forthcoming in coming months I will not hesitate to move forward quickly to have the issue **addressed by regulatory action**".*
- Yesterday: *"I do not think credit rating agencies can expect to emerge from this crisis without **significant changes to the way they operate**".*

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## Way forward

And yet we can see some initiatives:

- Individual initiatives of the agencies
  - Moody's (Moody's consultation some days ago)
  - S&P (announced yesterday)
- On Wednesday, IOSCO announces a proposal for changes in CRAs code of conduct. Consultation to start in March
  - Disclosure of the assumptions underlying the individual ratings for structured finance transactions;
  - Prohibition of advice on the design of structured products which an agency also rates
  - Reasonable steps being taken to use information of sufficient quality to support a credible rating.

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