

CITIZENS' SUMMARY

New EU rules on issuing credit ratings

The European Commission has put forward a proposal on credit rating agencies. The proposal is one of the measures to address the financial crisis. It aims at restoring market confidence and ensuring investor protection.

What's the issue?

Credit rating agencies (CRAs) provide independent opinions on what is the probability of default of companies, governments and a wide range of financial instruments. This is the likelihood that such actors might not be able to repay their debts. The conclusion of a CRA's assessment is summarised in a mark, or "rating" attributed to an issuer or its instrument. Credit ratings have major impact on the availability and cost of credit for borrowers/issuers.

CRAs contributed significantly to the current problems in the financial markets. They clearly underestimated the risk that the issuers of certain more complicated financial instruments may not repay the debts. As they gave the highest possible ratings to many of those innovative instruments, inexperienced investors felt encouraged to purchase them, even without assessing properly the risks. As market conditions were worsening, CRAs failed to reflect this promptly in their ratings. These failures by CRAs were combined with an imprudent approach of the investors. As a result, credit was granted even if it would not be justified by economic fundamentals.

Proposed solution:

This initiative tackles the problems identified in the issuance of credit ratings.

How will the Proposal help?

- **by requiring registration of all CRAs that would like their ratings to be used by banks and insurance companies in the EU**
- **by introducing a series of concrete requirements, which stipulate how a CRA should deal with conflicts of interest, ensure the quality of ratings and be more transparent towards the users of ratings**
- **by making the CRAs subject to public supervision.**

Why has the EU done this?

The Commission wants to ensure that the ratings used in the EU are independent, objective and of the highest quality. A common legal framework needs to be applied evenly in all

Member States. This will strengthen the functioning of the internal market in financial services and ensure the same levels of investor protection across the EU.

Whom will it help?

All users of ratings will benefit from the proposal. Improved performance of CRAs will be crucial to rebuilding confidence in the financial markets and unlocking the credit markets to the needs of the wider economy.

How would it work?

A registered CRA will need to comply at all times with requirements laid down in the Regulation. This will involve changes to their internal organisation and the way they operate. CRAs will become more transparent. This will make it easier for users of ratings to decide for themselves if they want to trust a specific rating agency or particular rating. CRAs will be subject to surveillance by the securities supervisors that already oversee EU's financial markets at national level. These supervisors will be expected to apply effective sanctions.

When would it come into effect?

The proposal for the Regulation will now be considered by the European Parliament and the Council. Once adopted, it will enter into force shortly after its publication in the Official Journal of the European Union and will apply to CRAs six months after that date.