



EUROPEAN COMMISSION
Directorate General Internal Market and Services

FINANCIAL INSTITUTIONS
Financial stability

ROUNDTABLE on CREDIT RATING AGENCIES

6 July 2011 (9.00 – 13.00)

Berlaymont Building, Rue de la Loi 200 – 1049 Brussels

Summary of points raised in the roundtable

The purpose of the roundtable was to gather views from various shareholders in order to shape future policy in the field of credit rating agencies (hereafter referred to as CRAs) complementing existing EU regulation. The roundtable was chaired by Deputy Director General of the Directorate General for Internal Market and Services, Mrs Nadia Calviño. Conclusions were drawn by Maria Velentza, Head of Unit of "Financial Stability" of the same Directorate General. It was attended by approximately 60 participants, representing all relevant stakeholder groups (European institutions and agencies, Member States, rating agencies, issuers, including various industry federations and representatives of the financial services industry, academia etc).

We have not attributed particular statements to individuals present, but have tried to represent the views expressed by various stakeholder groups. The following is only intended as a summary of the discussion that occurred on this day, and does not try to represent the official lines taken by particular industry representatives, bodies or Member States.

Overreliance on CRAs

Issues debated:

- What alternative measures of credit risk could be used instead of external credit ratings? Does the answer differ across asset classes: corporate, financial, sovereign, structured finance?
- Should alternative measures of credit risk, including internal models and enhanced risk management, be used in isolation or in combination with external ratings?
- How do you assess transparency and data availability in structured finance? Is there enough transparency to allow financial firms to assess the credit risks of structured finance instruments themselves?

In this section of the discussion, participants were unanimous on the importance of reducing overreliance on ratings, particularly mechanistic reliance. Although there was consensus that action should be taken, some participants cautioned against overreacting in the wake of the crisis.

A number of participants said that market players including investors did not perform enough of their own due diligence and risk analysis or did not have sufficient understanding of ratings.

In order to facilitate improved due diligence and credit risk assessment, many proposed greater transparency and access to information. However, some warned that simply providing more information would not lead to greater understanding and less overreliance, stressing the need to incentivise market participants' own due diligence, including in the area of product innovation.

Some participants raised the issue of intellectual property in relation to transparency, though not all agreed this was an issue.

A large number of participants said that references to ratings in legislation were important in driving overreliance and that they should be removed, though some called for this to be done gradually. However, the general consensus was that removing references to ratings in legislation is just one step and is not an immediate cure.

Some cautioned that a move to internal ratings could take time in order to first ensure quality or because such ratings would also be subject to conflicts and quality issues. Some of these participants mentioned that in particular some SMEs do not currently have the capacity to perform their own ratings and process large amounts of information.

Participants acknowledged the difficulty in finding suitable alternatives to ratings in legislation. A few participants drew a link between overreliance and competition. In addition, the presence of ratings in private contracts, particularly in the asset management sector was raised, although this falls outside of the remit of EU legislation.

A number of participants raised the importance of supervision and enforcement to ensure appropriate use of and to prevent overreliance on ratings.

Sovereign debt ratings

Issues debated:

- Do you agree that the specificities of sovereign debt ratings justify enhanced requirements for sovereign debt ratings compared to other rating classes? If this is the case, what kind of requirements would you suggest?
- How can the transparency and monitoring of sovereign debt ratings be improved?
- How can investors' understanding of sovereign debt rating actions be enhanced?

Many participants expressed serious concerns with some sovereign ratings issued by large CRAs. Some referred to concrete examples of recent European downgrades that they found inexplicable since some CRAs appeared to fail to take account or assess in a consistent manner all relevant information, such as support initiatives and other factors, when issuing ratings. Others did not understand why major rating changes were made when no new information was available. Participants said that some ratings issued by CRAs were 'not logical', 'questionable' 'disruptive' and 'not credible'.

Some participants countered that some inaccurate statements were made, and that ratings are imperfect due to their forward-looking nature, adding further that methodologies were publicly available.

There was no consensus as to whether sovereign ratings should be subject to a specific regulation. Some participants felt that sovereign rating should be distinguished from other rating classes, whereas others felt that it should not be treated differently.

Some said it was important to take into account spillover effects and that in general, more understanding of sovereign ratings was needed.

One participant said that not only references to ratings in legislation, but risk weightings for sovereign debt had encouraged a cycle of irresponsible borrowing, but also irresponsible lending. A few participants considered possible to set up a European body to rate sovereign debt, though others were against, stressing the importance of maintaining a level playing field.

There were several calls for increased transparency. There was general consensus on publication of full reports and explanation and justification behind sovereign rating changes, and also detail on the staff involved and time devoted to the rating.

There was opposition to the possible measure included in the consultation to requests 3 days' notice to be given for sovereign rating changes, mainly because of market abuse risks. However, some called for notice to be given with sufficient working hours to respond, rather than the current 12 hour requirement.

Some said it was important to increase competition to increase the number of opinions in the market. One participant suggested distinguish between issuer pays and investor pays models when drafting rules, as an advanced notice rule would not be suitable for an investor solicited rating.

Enhancing competition in the CRA industry

Issues debated:

- How can new players be encouraged to enter the credit rating agency sector?
- What are your views about creating a network of CRAs? Do you consider that such a network could help increase competition in the credit rating agency sector?
- What are your views about creating a new independent European Credit Rating Agency?

Many participants expressed concern at the oligopolistic structure of the credit rating market, despite the existence of strong regional or specialist players, and stressed the need to increase competition and to encourage more players in the market. One cited a past example of large corporations downgraded by some rating agencies, whereas other agencies maintained investment grade ratings, allowing the corporations to continue to raise funding and to continue to be profitable today. Some noted the importance of local knowledge in this respect.

A few participants said that more players would not necessarily improve competition or that more competition could be stimulated within the current structure. One participant thought that more competition could worsen the quality of ratings, though this was contested by other participants.

A representative of the European Parliament explained the proposals regarding the creation of a publicly supported new European rating agency in the form of a foundation

for which the European Parliament requested the Commission to conduct an in-depth assessment.

The majority of participants were against a European rating agency as a public initiative, regardless of how it was funded. Some cited the long timeframe of around 10 years it might take for such an institution to gain credibility, while others thought it never would due to the questions about its independence and absence of conflicts of interest. Some felt that one new, large player would not increase competition. Others felt it was not appropriate to give public support to one specific agency or project over the rest, as this would distort competition.

A number of participants called for regulation to reduce and not increase barriers to entry. One participant noted that despite private ownership, CRAs have an important public responsibility and should base their actions on the public good. One proposed stimulating more competition by promoting comparability of the performance of ratings issued by CRAs.

Conflicts of interest in the issuer pays model

Issues debated:

- What are your views about the model currently discussed in the US (selection of the CRA by an independent board)?
- What are your views with respect to a regular rotation between CRAs in order to mitigate conflicts of interests due to the issuer-pays model?

Some participants noted that no model is free of conflicts of interest. One proposed the creation of a private not for profit investor-pays model foundation, suggesting that by having several stakeholders with different interests, conflicts could be minimised. Several participants called for more focus on conflicts in the registration process.

Some participants called for greater transparency to counter conflicts.

A few participants drew comparisons to the audit industry, with some advocating mandatory rotation. However others cautioned against this. A few participants cautioned against conflicts created by the shareholding structure of the largest CRAs, and the similarity between their shareholders.

One said that the issuer pays model had allowed issuers to bribe for favourable ratings, but this statement was strongly rejected by others.

Civil liability of CRAs

Issues debated:

- Do you think that credit rating agencies should be held liable if they infringe negligently or intentionally the CRA Regulation, thereby causing damage to investors?
- Do you see benefit in introducing a civil liability regime for CRAs in the CRA Regulation or should national legal orders provide for such a regime?

Some supported more stringent liability for CRAs, a few drawing parallels to the audit industry. A standard of gross negligence or intent was suggested. The opinion was also expressed that it would be easier to pursue liability claims against CRAs by moving to an investor-pays based model.

There were calls in various parts of the discussion by participants for CRAs to take responsibility for their actions, especially in view of the serious potential consequences. Some noted that CRAs can be sued, and that they sometimes are.