

CHAMBER OF DEPUTIES
6th (Finance) Standing Committee

Final document pursuant to article 127 of the Regulation on:

Proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EEC) no. 1060/2009 on credit rating agencies (COM (2010) 289 final)

Approved on 19 October, 2010

The Finance Committee of Italy's Chamber of Deputies

Having examined the Proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EC) no. 1060/2009 on credit rating agencies (COM (2010) 289 final)

Whereas:

The recent financial crisis has highlighted a series of particularly worrying critical issues regarding the part in it played by the credit rating agencies;

In particular, the credit rating agencies, which were first established with the basic aim of reducing information asymmetries in the financial markets, have often shown that they are not equal to the task because, in many instances, they have failed to promptly highlight the serious financial imbalances that were undermining the stability of numerous issuers;

There are certainly many reasons for these shortcomings which not only have to do with the exceptional magnitude of the crisis but also the lack of an adequate regulatory and supervisory framework for the work of the credit rating agencies, and with certain features of the agencies themselves which impair their efficient operation;

In relation to the first aspect, it has become evident that a self-regulatory approach to credit rating agencies is totally inadequate, and that a proper regulatory framework is needed, as closely integrated at the international level as possible.

With reference to the latter aspect, it has become evident that a number of fundamental problems adversely affecting the efficient operation of the credit rating agencies need to be resolved:

The conflicts of interest between credit rating activities performed by agencies and the consultancy services they provide to the issuers of the financial instruments which they rate;

The distortions which may be embedded in the mechanisms for remunerating the credit rating services which are not paid for by the parties using the information given with the ratings, but by the parties issuing the financial products being rated;

The virtual oligopoly that exists on the credit rating services market which, particularly in certain parts of the world, appears to be limited to the three leading credit rating companies;

The inadequate transparency of the rating mechanisms and procedures;

More generally, we should question the role given to the credit rating agencies, which in some countries have the statutory authority to issue regulatory licenses to issuers, because their ratings on individual financial instrument are no longer purely a matter of opinion about the level of risk of the instrument being rated, but are a sort of certification with legal and economic effects that are important for enabling securities intermediaries, institutional investors and private investors to take decisions, and for the overall operation of the financial and credit markets, and for the purposes of supervision;

What is needed, conversely, is to ensure that the assessments made by brokers and institutional investors and savers about the issuers and the financial instruments, are not based uncritically on ratings issued by the credit rating agencies, and that the supervisory authorities do not unconditionally accept the agencies' assessments for the purposes of regulation;

These requirements become even more essential when one considers the fundamental role played by "external" ratings from the point of view of granting credit for productive activities, in the light of the function attributed to these ratings by the "Basle 2" agreement and reiterated in the new "Basle 3" agreement, for the purposes of determining capital ratios requirements that banks must meet;

Neither can one ignore the crucial impact that ratings have on the prices of government bonds, and hence on the management of sovereign debt and indirectly on the very stability of the Euro monetary system;

Noting that:

The proposal for a Regulation examined here is a further step forward in the process that began with the adoption of Regulation (EC) no.1060/2009, to place the rating industry within an effective and mandatory regulatory framework;

Specifically, the proposal for a Regulation makes it possible to move beyond the previous "collegial" supervisory approach, and entrust overall supervision of credit rating agencies to one single authority at the level of the European Union, namely, the newly-constituted *European Securities Market Authority* (ESMA);

Furthermore, this proposal introduces a number of appropriate elements to ensure greater transparency regarding access to the information used by the credit rating agencies to produce their ratings, thereby having a positive, albeit still inadequate, effect of helping to find a solution to the issue of conflicts of interest;

Vesting ESMA with powers of supervision over the credit rating agencies is a very positive result, as their supranational nature makes any fragmented regulatory and supervisory approaches at the national level wholly ineffective;

The policy implemented in this proposal to vest the European Commission with the competence to issue penalties, instead of giving ESMA these powers, does not, however, appear to be wholly acceptable, and contradicts the European rules governing the industry in that it hampers the pursuit of the objective of strengthening the autonomy and independence of the

supervisory bodies;

It is also essential in this area to ensure close and fruitful interaction between ESMA and the national authorities which, while devolving onto the new authority most of the powers to gather information on, investigate and inspect the credit rating agencies, must also ensure an ongoing flow of information to ESMA;

The regulatory framework for credit rating agencies cannot, however, be considered complete, despite the positive objectives already attained with the entry into force of Regulation no.1060/2009 and the adoption of the proposal for a Regulation examined here;

Firstly, it is to be hoped that there will be coordination at international level among all the supervisory authorities concerning the operation of credit rating agencies, of which the largest operate worldwide;

Secondly, it is necessary to address even more effectively the issue of credit rating agencies' conflicts of interest and the inherent contradictions in the mechanisms for paying for their ratings;

Thirdly, it is to be hoped that more competition will be introduced into the credit rating market, for example, by providing incentives for the establishment of regional/local credit rating agencies both to overcome what is at present essentially an oligopoly, and to increase the agencies' capacity to perform assessments that take proper account of specific national economic environments, which in some cases are characterised by the predominance of SMEs;

Stressing the need for this final document, together with the opinion of the European Union Policies Committee to be promptly forwarded to the European Commission as part of the political dialogue, as well as to the European Parliament and the Council,

URGES THE GOVERNMENT

to act in all the decision-making fora of the European Union in order to:

(a) advocate that ESMA be directly authorised to impose penalties for violations of the provisions of Regulation no.1060/2009, in compliance with the constraints imposed by the treaty and by European Court of Justice case law, clearly setting out the scope of the discretion enjoyed by that authority in the exercise of those powers, guaranteeing the necessary separation between the investigation phase and the judgment phase, or alternatively to ensure that the European Commission may not pronounce on the merits of any proposed penalties made by ESMA but merely give them legal effect;

(b) ascertain whether the proposal to draw up a mandatory list of offences attracting the penalties or supervisory measures set out in Appendix III to be introduced into Regulation No.1060/2009, might give rise to the risk of opening up possible regulatory loopholes which would prevent appropriate penalties from being imposed for other unlawful or improper actions;

c) ensure that, in the context of the new centralised supervisory system, closer cooperation between ESMA and the national supervisory authorities so as to exploit the know-how acquired by the latter in their daily work of supervising the financial market, in order to be

able more effectively to identify any violations of Regulation No.1060/2009 and hence steer the subsequent supervisory and penalty-issuing work of ESMA;

(d) in particular, appraise whether it would be appropriate to make express provision to ensure that in the case of supervisory activities requiring direct contact with the local branches of the credit rating agencies, the individual national authorities, acting directly, may require these agencies to furnish them with information and documents in order to improve the effectiveness of their reporting activities to ESMA;

(e) argue that the supervisory system set out in the proposal for a Regulation under examination be regularly reviewed in order to see whether any corrective measures are needed;

(f) in this connection, give serious thought to any further regulatory measures that may be required to resolve the evident conflicts of interest of the credit rating agencies, avoiding the risk, which is particularly strong in the case of global credit rating agencies, that the ban on credit rating agencies, provided by Appendix I, Section B, paragraph 4 of Regulation no. 1060/2009, prohibiting them from providing consultancy services to the entities being rated, or to related third parties, is evaded by entrusting these consultancy services to parties controlled by, related to, or in any way connected with the credit rating agency itself, even if registered in other jurisdictions, and extending the obligation provided by Appendix I, Section B, paragraph 2, of Regulation No.1060/2009 to report the names of the entities being rated or of related third parties supplying over 5% of the credit rating agency's annual turnover, as well to the subsidiaries, related parties or parties in any way linked to the credit rating agency.

(g) similarly, to proceed rapidly to examine the appropriateness of reviewing the procedures for remunerating the credit rating services and to identify measures to open the credit rating market more broadly, with the market entry of new agencies;

(h) in the latter connection, to see whether it would be appropriate to foster the development of regional or local credit rating agencies, partly with the purpose of enabling small and medium enterprises to obtain ratings, thereby increasing their possibility of having access to the financial markets under more transparent conditions;

(i) in more general terms, to begin examining the appropriateness of reviewing the regulatory role attributed to the ratings issued by credit rating agencies as well as the impact of ratings on markets' operation, namely by eliminating or significantly reducing the regulatory role of ratings, along the lines of Section 939 of the Dodd-Frank Act that was recently enacted in the United States of America, which provides for the gradual elimination of references to ratings in supervisory regulations;

(j) to see whether it is appropriate, moreover, to withdraw some of the regulatory privileges presently enjoyed by the credit rating agencies, such as the virtual exemption from the obligations of transparency and disclosure of their conflicts of interest, set out in directive 2003/125/EC, in implementation of directive 2003/6/EC on market abuse;

(m) to examine the possibility of introducing mechanisms to make the credit rating agencies liable in law in the event that their ratings prove to be seriously flawed.