



EUROPEAN COMMISSION  
IMPACT ASSESSMENT BOARD

Brussels,  
D(2011)

## Opinion

**Title**                    **DG MARKT - Impact Assessment on a proposal for a regulation on credit rating agencies (CRA III)**

**(draft version of 7 September 2011)**

### **(A) Context**

In one of its first initiatives to respond to the financial crisis, the Commission proposed Regulation (EC) N° 1060 / 2009 on credit rating agencies (CRAs) which entered into full application on 7 December 2010. Spurred by the CRAs role in the build-up to the crisis, the regulation replaced a self-regulatory approach with a new system requiring CRAs' registration and supervision according to strict standards of integrity, quality and transparency. Following changes in the overall architecture for EU financial market supervision, the regulation was amended on 11 May 2011 (CRA II) to entrust the European Securities and Markets Authority (ESMA) with exclusive supervisory powers over CRAs registered in the EU. The Commission is now considering a second set of amendments (CRA III) given persisting questions about CRAs' activities and the use of their ratings, particularly in the context of the ongoing Euro area sovereign debt crisis.

### **(B) Overall assessment**

**The report provides the necessary analysis to support action in this area but should be further improved in some respects. The analysis should clarify the nature of the problems and better explain their persistence despite recent measures in the same area. It should also clarify and better substantiate the specific issues affecting sovereign ratings. The report should strengthen the analysis of impacts for some options, including the proposed strengthening of the powers of the European Securities and Market Authority. The implications of the limited territorial and jurisdictional applicability of EU law should also be systematically discussed when evaluating the effectiveness of individual measures. This strengthened analysis of individual policy options should be complemented by a deeper assessment of the overall impact and proportionality of the preferred package of policy options. This should take into account synergies and trade-offs among the planned measures and include a comparison with other possible policy packages. Finally, stakeholders' views should be discussed more extensively in the main text of the report.**

**During the meeting, DG MARKT agreed to revise the report in line with the recommendations of the Board.**

### **(C) Main recommendations for improvements**

**(1) Clarify the analysis of problems.** The report should clarify whether the problems identified are related to the quality and transparency of CRA ratings, the pro-cyclicality of their changes or their use by investors. Given recent measures in the same policy area, the report should more clearly show why the identified problems would not be addressed under the baseline scenario. In order to do so, the main text should recall the key measures already adopted (or proposed as for the Capital Requirement Directive). The analysis of the problems should also clarify and better substantiate the specific issues affecting sovereign ratings, avoiding judgements on specific decisions in the absence of credible supporting evidence. For the case of sovereign ratings, as well as for those relating to structured financial products transparency, high market concentration, limited rating comparability and cross-ownership, the report should either provide greater evidence of the detrimental impact of these issues or explicitly justify the application of the precautionary principle.

**(2) Improve the analysis of impacts for some proposed options.** The assessment of the option to reduce references to external credit ratings in EU legislation should take greater account of the risks and costs of internal risk monitoring, the foregone benefits of specialisation and scale in the credit rating business and the non-regulatory reasons for which rating changes may continue to affect market behaviour significantly. The report should also better justify the need and scope of the power to temporarily restrict ratings of sovereign issuers in exceptional circumstances as proposed for the European Securities and Market Authority (ESMA). The report should also clarify the exact nature and scope of the proposed extension of the ESMA's powers to scrutinize/validate rating methodologies and assess the compatibility of such extended powers with existing legislation. Finally, the report should provide a stronger justification for the proposed measures to support the emergence of a network of small and medium size rating agencies and to establish a right of redress for investors. With regard to the latter, the report should clarify its relevance as a specific problem in the case of credit rating agencies, better analyze its potential costs and impacts on smaller agencies and highlight how potential subsidiarity concerns would be taken into account.

**(3) Strengthen the analysis of the proportionality and effectiveness of the preferred policy package.** The analysis of the impact of individual measures should be complemented by a deeper assessment of the overall impact and proportionality of the full package of preferred policy options. In so doing, the report should show that each preferred measure remains necessary after taking into account any synergy or trade-off with the other planned measures. The report should clarify whether, for instance, effective rating supervision, reduced references in EU legislation and enhanced ratings' quality and transparency might already eliminate the need for some other measures such as temporary bans or investment prohibitions for controlling stakeholders. The report should also include a comparison between the preferred policy package and those alternative combinations of measures that would reflect different views on the relevance of the identified problems and the relative efficiency of the options. Finally, when evaluating the effectiveness of the preferred package, the report should systematically assess the implication of the limited territorial and jurisdictional applicability of EU law for individual measures (including investment prohibitions and the timing of sovereign rating changes). Where relevant for the overall effectiveness of the package, the report

should clarify the timing of the proposed measures.

**(4) Better present stakeholders' views.** The main text of the report should illustrate more extensively stakeholders' views both in favour of and against the report's analysis of problems and assessment of the preferred options.

*Some more technical comments have been transmitted directly to the author DG and are expected to be incorporated in the final version of the impact assessment report*

**(D) Procedure and presentation.**

Although the report is drafted in relatively simple language, its clarity could be further improved. To this end, a simplification of the presentation of the many options under analysis should be considered, including by packaging some options in the main text (and by better explaining the differences between option 8 under objective 2 and option 3 under objective 3). A summary of the whole package, presenting only the preferred options should also be included in the main text, specifying the concrete legal instrument to be adopted. Finally, an additional annex focussed on the complementarities with the proposed revision of the Capital Requirement Directive could be usefully added.

The executive summary should be shortened within the allowed 10-page limit and should pay greater attention to the assessment of options and stakeholder views. Conversely, issues concerning the choice of legal instrument could be dealt with in a much more concise manner.

**(E) IAB scrutiny process**

Reference number	2011/MARKT/010
External expertise used	No
Date of Board Meeting	5 September 2011