

III

(Preparatory acts)

EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 2 April 2012

on a proposal for a regulation amending Regulation (EC) No 1060/2009 on credit rating agencies and a proposal for a directive amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings of collective investment in transferable securities (UCITS) and Directive 2011/61/EU on alternative investment funds managers in respect of the excessive reliance on credit ratings

(CON/2012/24)

(2012/C 167/03)

Introduction and legal basis

On 13 December 2011, the European Central Bank (ECB) received a request from the Council of the European Union for an opinion on a proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) No 1060/2009 on credit rating agencies ⁽¹⁾ (hereinafter the 'proposed regulation') and on 21 December 2011 on a proposal for a directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings of collective investment in transferable securities (UCITS) and Directive 2011/61/EU on alternative investment funds managers in respect of the excessive reliance on credit ratings ⁽²⁾ (hereinafter the 'proposed directive').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union since the proposed regulation and the proposed directive contain provisions affecting the European System of Central Banks' contribution to the smooth conduct of policies relating to the stability of the financial system, as referred to in Article 127(5) of the Treaty. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

General observations

The ECB shares the general objective pursued under the proposed regulation and the proposed directive which is to contribute to reducing financial stability risks and restoring the confidence of investors and market participants in financial markets and ratings quality. The proposed measures are aimed at: (a) reducing excessive reliance on external ratings; (b) mitigating the risks of contagious effects linked to changes in sovereign ratings; (c) improving credit rating market conditions with a view to improving the quality of ratings; (d) ensuring a right of redress for investors; and (e) improving the quality of ratings by reinforcing the independence of credit rating agencies (CRAs) and promoting sound credit rating processes and methodologies. The ECB has a keen interest in regulatory initiatives that reduce reliance on external credit ratings ⁽³⁾. The perceived existence of shortcomings in CRAs' ratings may have important effects on

⁽¹⁾ COM(2011) 747 final.

⁽²⁾ COM(2011) 746 final.

⁽³⁾ See the European Commission's public consultation on credit rating agencies — Eurosystem reply, February 2011 (hereinafter the 'Eurosystem reply') available on the ECB's website at: <http://www.ecb.europa.eu>

market confidence and possible adverse effects on financial stability. Against this backdrop, the ECB shares the Commission's specific objective of reducing excessive reliance on external credit ratings, which is in line with the principles established by the Financial Stability Board (FSB) in this field ⁽⁴⁾.

The ECB also supports the comprehensive powers entrusted to the European Securities and Markets Authority (ESMA) relating to authorisation and supervision of CRAs. ESMA's additional tasks under the proposed regulation will contribute to improving credit rating market conditions with a view to improving the quality of ratings and the promotion of sound credit rating processes and methodologies ⁽⁵⁾.

Specific observations

1. *Excessive reliance on external credit ratings*

Credit risk assessment by financial institutions

- 1.1. Under the proposed regulation, financial institutions have to make their own credit risk assessment and not 'solely or mechanically rely on credit ratings for assessing the creditworthiness of an entity or a financial instrument' ⁽⁶⁾. Moreover, competent authorities in charge of supervising these undertakings have to 'closely check the adequacy of undertakings' credit assessment process' ⁽⁷⁾. These provisions reflect the findings of the de Larosière Report ⁽⁸⁾ and reflect the FSB principle under which banks, market participants and institutional investors should be expected to make their own credit assessments ⁽⁹⁾.
- 1.2. The ECB supports the FSB's and the Commission's common objective of reducing overreliance on external credit ratings ⁽¹⁰⁾. More specifically, the ECB notes that the proposal for a directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate ⁽¹¹⁾ includes provisions addressing this issue with an emphasis on the development of internal approaches by credit institutions for calculating own funds requirements and also in connection with credit and counterparty risk ⁽¹²⁾. In addition, while financial institutions should also be required to develop adequate risk assessment capabilities, these capabilities should be in proportion to the nature, size and complexity of their activities.

The ECB also notes the corresponding amendments introduced in Directive 2009/65/EC and Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No

⁽⁴⁾ See Principles for reducing reliance on CRA ratings, Financial Stability Board, 27 October 2010 (hereinafter the 'FSB principles') and also, in Annex II, an overview of the Eurosystem Credit Assessment Framework policy in this field.

⁽⁵⁾ See, for instance, Opinion CON/2010/82 of 19 November 2010 on a proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) No 1060/2009 on credit rating agencies, paragraphs 1 and 2. All opinions are published on the ECB's website at: <http://www.ecb.europa.eu>

⁽⁶⁾ Article 1(6) of the proposed regulation, new Article 5a, first sentence.

⁽⁷⁾ Article 1(6) of the proposed regulation, new Article 5a, second sentence.

⁽⁸⁾ See the Report of the High-Level Group on Financial Supervision in the EU chaired by Jacques de Larosière, 25 February 2009, pp. 19-20. The Group is of the view that the use of ratings required by some financial regulations raises a number of problems, but is probably unavoidable at this stage. However, the Group considers that it should be significantly reduced over time. Supervisors should check that financial institutions have the capacity to complement the use of external ratings (on which they should no longer excessively rely upon) with sound independent evaluations.

⁽⁹⁾ See FSB principles, Principle II, Reducing market reliance on CRA ratings.

⁽¹⁰⁾ See Section 3.4.2 of the explanatory memorandum to the proposed regulation, p. 7 and the accompanying impact assessment, pp. 11-13 and 25-28.

⁽¹¹⁾ COM(2011) 453 final.

⁽¹²⁾ See Articles 76(2) and (3) and 77 of the proposal for a directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, COM(2011) 453 final (the 'proposed CRD IV directive'). See also Article 395 of the proposal for a regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, COM(2011) 452 final (the 'proposed CRD IV regulation').

1060/2009 and (EU) No 1095/2010⁽¹³⁾. Therefore, in order to ensure consistency between the proposed regulation and corresponding provisions in the sectoral legislation, the ECB recommends clarifying the nature of the obligation imposed on financial institutions in the proposed regulation.

References to external ratings in Union legislation

- 1.3. Under the proposed regulation EBA, EIOPA and ESMA must not refer to credit ratings in their guidelines, recommendations and draft technical standards 'where such references have the potential to trigger mechanistic reliance on credit ratings by competent authorities or financial markets participants'⁽¹⁴⁾. The proposed regulation also suggests that, by 31 December 2013, EBA, EIOPA and ESMA review and remove, where appropriate, all references to credit ratings in existing guidelines and recommendations⁽¹⁵⁾. A similar requirement is imposed on the European Systemic Risk Board (ESRB) with regard to its warnings and recommendations⁽¹⁶⁾.
- 1.4. The ECB understands that all the proposed amendments are aimed at implementing the FSB principles, which invite 'standard setters and authorities to assess references to CRA ratings in standards, laws and regulations and, wherever possible, remove them or replace them by suitable alternative standards of creditworthiness'⁽¹⁷⁾. However, while it might be advisable to remove provisions imposing compulsory recourse to external ratings from Union and national legislation or even all references to external ratings to the extent that these requirements or references to external ratings might be perceived as encouraging 'mechanistic' recourse to such ratings, the ECB would recommend caution regarding the drafting proposed in the above provisions of the proposed regulation⁽¹⁸⁾, as this could prove difficult to apply.
- 1.5. First, as regards the European Supervisory Authorities (ESAs), Level 1 Union financial services legislation refers to external credit ratings or credit assessments. This is, for instance, the case in Union banking legislation which refers to credit assessments by external credit assessment institutions (ECAIs)⁽¹⁹⁾ and formally requests EBA to develop draft technical standards related to credit assessments⁽²⁰⁾. Draft technical standards developed by the ESAs are adopted by the Commission on the basis of the empowering provisions contained in the Level 1 legislation⁽²¹⁾ and aim at further supplementing or specifying these provisions. Therefore, a prohibition on referring to credit assessments in the abovementioned texts seems difficult to apply, even if a certain degree of judgment was left to the ESAs by the words 'where appropriate'⁽²²⁾. In particular, the assessment of whether references to credit assessments effectively have 'the potential to trigger mechanistic reliance', instead of allowing an informed assessment by investors and market participants, is subjective, which renders its introduction as a legal requirement in the proposed regulation problematic.
- 1.6. Second, as regards the ESRB, the abovementioned prohibition on referring to credit ratings in ESRB warnings and recommendations also seems disproportionate since credit ratings constitute a valuable source of information and provide benchmarks or models that the ESRB may use in the context of its tasks.

⁽¹³⁾ OJ L 174, 1.7.2011, p. 1. See also Articles 1 and 2 of the proposed directive.

⁽¹⁴⁾ Article 1(6) of the proposed regulation, new Article 5b, first paragraph.

⁽¹⁵⁾ See footnote 14.

⁽¹⁶⁾ Article 1(6) of the proposed regulation, new Article 5b, second paragraph.

⁽¹⁷⁾ See FSB principles, Principle I, Reducing reliance on CRA ratings in standards, laws and regulations.

⁽¹⁸⁾ See Article 1(6) of the proposed regulation, new Article 5b.

⁽¹⁹⁾ See, for instance, as regards credit assessments by ECAIs, Articles 80 to 83 and 96 to 99 of and Annexes VI and IX to Directive 2006/48/EC, Articles 130 and following of the proposed CRD IV regulation and Articles 109a(1)(b) and 111(1)(n) of the proposal for a directive of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (COM(2011) 8 final) (hereinafter the 'proposed "Omnibus II" directive').

⁽²⁰⁾ Articles 81(2) and 97(2) of Directive 2006/48/EC.

⁽²¹⁾ See, for instance, Article 81(2), second subparagraph of Directive 2006/48/EC, Article 131(1) of the proposed CRD IV regulation and Article 111(1)(n) of the proposed 'Omnibus II' directive.

⁽²²⁾ As suggested in Article 1(6) of the proposed regulation, new Article 5b, last sentence of first paragraph.

- 1.7. Overall, the ECB supports the FSB's view that CRAs play an important role and that their ratings can appropriately be used by firms as a part of their internal credit assessment processes⁽²³⁾. In this context, the purpose of the current reform is to reduce overreliance on external credit ratings and to enhance their quality, but not to eliminate their use. At the same time, the use of CRAs' ratings by a firm does not lessen its own responsibility to ensure that its credit exposures are based on sound assessments⁽²⁴⁾. The ECB supports the gradual approach advocated by the FSB and notes that references to CRAs' ratings should be removed or replaced only once credible alternatives have been identified and can safely be implemented. In this context, it is necessary that standard setters and authorities develop transition plans and timetables to enable the removal or replacement of references to CRAs' ratings wherever possible and the associated enhancement in risk management capabilities to be safely introduced.
- 1.8. The ECB recommends replacing Article 1(6) of the proposed regulation⁽²⁵⁾ by a recital in the proposed regulation that reminds public authorities of the importance of contributing where appropriate to the abovementioned objective of reducing excessive reliance on external credit ratings. The ECB also notes that under the proposed CRD IV directive⁽²⁶⁾ EBA, in cooperation with EIOPA and ESMA, will publish a biannual report on the extent to which Member State legislation refers to external ratings and on steps taken by Member States to reduce such references. The ECB recommends that the ESAs, after having taken account of the contributions of the ECB and of the ESRB, report to the Commission on possible alternative or complementary solutions with regard to references to external ratings in Union and national legislation.
- 1.9. For information purposes, Annex II to this Opinion describes the credit assessment methodologies used by the Eurosystem in the context of collateral eligibility for liquidity operations.

2. **Credit rating agencies and external credit assessment institutions**

External credit assessments and eligibility of ECAIs

- 2.1. Regulation (EC) No 1060/2009 provides that a credit agency must apply for registration as a condition for being recognised as an ECAI⁽²⁷⁾ in accordance with Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking-up and pursuit of the business of credit institutions⁽²⁸⁾ and that this registration procedure should not replace the established process of recognising ECAIs in accordance with Directive 2006/48/EC⁽²⁹⁾.
- 2.2. Under the proposed CRD IV regulation⁽³⁰⁾, the procedure of ECAI recognition by competent authorities results in 'automatic' eligibility of CRAs that are registered or certified in accordance with Regulation (EC) No 1060/2009. This also applies to central banks issuing credit ratings which are exempt from that Regulation⁽³¹⁾. The ECB supports the new procedure contained in the proposed CRD IV regulation, as it will contribute to simplifying the recognition procedure for ECAIs and ensuring cross-sectoral consistency⁽³²⁾. For the sake of legal clarity and transparency, the ECB would however suggest further clarifying in a recital of the proposed regulation that the entry into force of the proposed CRD IV regulation will imply an automatic recognition of the above CRAs and central banks (as ECAIs) and that there is a need to define the correspondence between credit assessments and credit quality steps, i.e. mapping.

⁽²³⁾ See FSB principles, Principle II.

⁽²⁴⁾ See footnote 23.

⁽²⁵⁾ Article 1(6) of the proposed regulation, new Article 5b.

⁽²⁶⁾ Article 150(2) of the proposed CRD IV directive.

⁽²⁷⁾ Article 2(3) of Regulation (EC) No 1060/2009.

⁽²⁸⁾ OJ L 177, 30.6.2006, p. 1.

⁽²⁹⁾ See recital 44 of Regulation (EC) No 1060/2009.

⁽³⁰⁾ See Articles 130(2) and 262(2) of the proposed CRD IV regulation.

⁽³¹⁾ Compare Articles 130, 131 and 133 of the proposed CRD IV regulation and Articles 81 and 97 of and Part II of Annex VI to Directive 2006/48/EC.

⁽³²⁾ See paragraph 6.4 of Opinion CON/2011/42 of 4 May 2011 on a proposal for a directive of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority.

Mapping and European rating index

- 2.3. The proposed regulation provides for the establishment by ESMA of a European rating index, which will include all credit ratings submitted to ESMA as well as an aggregated rating index for any rated debt instrument⁽³³⁾. The index and individual credit ratings will be published on ESMA's website. Under the proposed regulation, the ratings submitted to ESMA will be based on a harmonised rating scale⁽³⁴⁾.
- 2.4. Whilst the ECB supports enhanced transparency, interoperability and comparability of ratings by market participants, it should however be ensured, in view of the possible negative effects on competition and on the diversity of rating methods, that a harmonised rating scale does not exert pressure on CRAs to harmonise methodologies and processes.
- 2.5. Moreover, the ECB notes that mapping procedures will be developed by EBA and EIOPA in the banking⁽³⁵⁾ and in the insurance sectors⁽³⁶⁾. In view of the cross-sectoral nature of these issues, it would be appropriate to coordinate the mapping exercises, possibly through the Joint Committee of the ESAs⁽³⁷⁾. In this context, the ECB recommends deleting the reference to the harmonised rating scale and suggests that, by December 2015, ESMA, in cooperation with EBA, EIOPA and the ECB, reviews the feasibility of establishing a harmonised rating scale for ratings issued by registered and certified CRAs and reports to the Commission on this issue. This would also entail replacing references to 'European rating index' with 'European rating platform' in the proposed regulation.

3. Other observations*Sovereign ratings*

- 3.1. The ECB supports the initiatives taken to enhance transparency and disclosure of the methodology and rating process in relation to sovereign debt⁽³⁸⁾. The proposed regulation introduces a special regime as regards the frequency of review and the procedure for the issuance of sovereign ratings. The ECB welcomes these proposed changes and notably the proposal to request CRAs to assess sovereign ratings more frequently. While ratings should only be published after the close of business and at least one hour before the opening of trading venues in the Union, the ECB considers that other initiatives could be taken to alleviate the potential pro-cyclical effects of changes in ratings. The ECB recommends exploring ways of reducing the volatility induced by the timing of the rating changes, notably when an issuer is on ratings watch and is close to losing its investment grade status as well as when a potential downgrade of several notches is being contemplated. In these situations, proposals to communicate more frequently to the market in ways that would smooth cliff effects could be further explored.

Moreover, the ECB notes that the proposed regulation provides that rating agencies accompany each issued sovereign rating or a related rating outlook with a detailed research report explaining all the assumptions, parameters, limits and uncertainties and any other element taken into account in determining that rating or outlook⁽³⁹⁾. In this respect, it might be appropriate to extend some of these requirements to other types of ratings, in particular the requirements for detailed information on the quantitative and qualitative assumptions justifying the reasons for the rating change and their relative weight.

Independence of CRAs

- 3.2. The ECB supports the Commission's proposals to address issues related to the independence of CRAs. However, since the current 'issuer-pays' financing model of ratings could be a source of conflict of

⁽³³⁾ Article 1(14) of the proposed regulation, new Article 11a.

⁽³⁴⁾ Articles 1(14) and 1(18) of the proposed regulation, new Articles 11a(1) and 21(4a).

⁽³⁵⁾ See Articles 131 and 265 of the proposed CRD IV regulation and Committee of European Banking Supervisors, Revised Guidelines on the recognition of External Credit Assessment Institutions, 30 November 2010, Part 3, available on the EBA's website at: <http://www.eba.europa.eu>

⁽³⁶⁾ See the proposal for a directive of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority, Presidency compromise of 21 September 2011, available on the Council's website at: <http://register.consilium.europa.eu>

⁽³⁷⁾ See Opinion CON/2011/42, paragraph 6.4.

⁽³⁸⁾ See the Eurosystem reply, paragraph 2.1.

⁽³⁹⁾ Annex I, point 6 of the proposed regulation.

interest and thus may have a distorting influence on ratings⁽⁴⁰⁾, more far-reaching solutions on alternative compensation models are warranted. The ECB welcomes therefore the Commission's continued work on monitoring the appropriateness of CRAs' remuneration models and looks forward to the submission of a report thereon to the European Parliament and the Council by the end of 2012, taking also account of the work in other jurisdictions, including the United States⁽⁴¹⁾.

- 3.3. While the ECB supports the proposals for stricter rules as regards shareholder structure of CRAs⁽⁴²⁾, the ECB recommends that the Commission reviews the proposed threshold of 5 %⁽⁴³⁾ in order to ensure its effectiveness.

Rotation principles

- 3.4. While the ECB supports the Commission's intention relating to the introduction of a rotation rule, i.e. that long-lasting relationships with the same rated entities could compromise the independence of ratings, possible unintended consequences may need to be further assessed⁽⁴⁴⁾. First, although a rotation rule should be conducive to preventing conflicts of interests stemming from the issuer-pays model, it should be avoided that the rotation of CRAs has a negative impact on the quality of ratings, in particular since there may be a risk that new entrants might compete by offering inflated ratings or by lowering prices. Second, a rotation rule should not lead to discontinued data pools as this would create issues regarding the validation of rating models. Third, for this provision to be effective, it needs to be ensured that there is a sufficient choice of CRAs fulfilling all minimum requirements, especially regarding the issuance of specific ratings, such as on structured finance products. Therefore, determining the exact number of years after which rotation should take place may warrant further analysis. Lastly, the interplay with the forthcoming assessment of the issuer-pays model⁽⁴⁵⁾ should also be considered in this respect.

Methodologies

- 3.5. The ECB supports the proposed tasks conferred upon ESMA with regard to the compliance of new or amended CRAs methodologies⁽⁴⁶⁾. The ECB recommends clarifying that ESMA's role is limited to verifying compliance of the methodologies with the applicable rules. Furthermore, it may be warranted to specify an applicable procedure and time frame to ensure that verification by ESMA does not prevent CRAs from issuing new ratings. The ECB also welcomes the proposal to require more and easily understandable guidance on methodologies and underlying assumptions behind ratings of all asset classes. Finally, the ECB welcomes the introduction of a public consultation on intended changes in rating methodologies, models or key assumptions.

Rules on structured finance instruments

- 3.6. The ECB welcomes the proposal to increase transparency as regards structured finance instruments⁽⁴⁷⁾. In particular, the ECB supports the proposed disclosure requirement of detailed information regarding structured finance instruments⁽⁴⁸⁾, namely through a centralised website⁽⁴⁹⁾ and the requirement of two credit ratings for structured finance instruments⁽⁵⁰⁾. On these aspects, the ECB would like to highlight the following:
- 3.7. First, with a view to ensuring cross-sectoral consistency and avoiding duplication of rules, the relationship between the disclosure requirements for issuers, originators and sponsors of structured finance products in the proposed regulation and similar disclosure requirements for securitisations in specific sectors should be clarified⁽⁵¹⁾.

⁽⁴⁰⁾ See the Eurosystem reply, paragraph 5.

⁽⁴¹⁾ See Article 1(24) of the proposed regulation, Article 39(1).

⁽⁴²⁾ See Article 1(8) of the proposed regulation, Article 6a.

⁽⁴³⁾ See Article 1(8) of the proposed regulation, Article 6a(1)(a).

⁽⁴⁴⁾ Article 1(8) of the proposed regulation, new Article 6b.

⁽⁴⁵⁾ Article 39(1) of Regulation (EC) No 1060/2009.

⁽⁴⁶⁾ Article 1(10) and (19) of the proposed regulation.

⁽⁴⁷⁾ Article 1(11) of the proposed regulation.

⁽⁴⁸⁾ Article 1(11) of the proposed regulation, new Article 8a(1).

⁽⁴⁹⁾ Article 1(11) of the proposed regulation, new Article 8a(4).

⁽⁵⁰⁾ Article 1(11) of the proposed regulation, new Article 8b.

⁽⁵¹⁾ See for example Article 122a of Directive 2006/48/EC, Article 17 of Directive 2011/61/EU, Article 50a of Directive 2009/65/EC and Article 135 of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) (OJ L 335, 17.12.2009, p. 1).

- 3.8. Second, the Eurosystem asset-backed securities (ABSs) loan-level information initiative establishes specific loan-by-loan information requirements for ABSs accepted as collateral in Eurosystem credit operations. It aims to increase transparency and make available more timely information on the underlying loans and their performance to market participants in a standardised format. In this regard, the ECB would note possible synergies to be pursued by ESMA when elaborating on the content and the formats for reporting of information on structured finance products ⁽⁵²⁾.
- 3.9. Third, the ECB welcomes initiatives contributing to the enhancement of transparency requirements in the structured finance instruments and covered bonds markets and the harmonisation of disclosure requirements in this area. In this context, the ECB supports the Commission's proposal to assess by 1 July 2015 the need to extend the scope of the reporting, inter alia, to covered bonds ⁽⁵³⁾. The ECB also notes that initiatives related to the transparency of the covered bonds market are considered in other ongoing legislative initiatives, for instance in the proposed CRD IV regulation ⁽⁵⁴⁾. Therefore, it is important to ensure the consistency of these various initiatives. Since the proposed regulation primarily regulates CRA activities, the above initiatives on transparency and disclosure for covered bonds should include an assessment in order to determine the appropriate Union legislative vehicles to introduce these measures, i.e., for instance in the framework of the proposed regulation and/or in other relevant Union financial services sectoral legislation.

Where the ECB recommends that the proposed regulation is amended, specific drafting proposals are set out in Annex I accompanied by explanatory text to this effect.

Done at Frankfurt am Main, 2 April 2012.

The President of the ECB
Mario DRAGHI

⁽⁵²⁾ Article 1(11) of the proposed regulation, new Article 8a(3).

⁽⁵³⁾ Article 1(24) of the proposed regulation, new Article 39(4).

⁽⁵⁴⁾ Article 478 of the proposed CRD IV regulation, Presidency compromise of 1 March 2012, available on the Council's website at: <http://register.consilium.europa.eu>

ANNEX I

Drafting proposals for the proposed regulation

Text proposed by the Commission	Amendments proposed by the ECB ⁽¹⁾
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Amendment 1

Recital 3a of the proposed regulation (new)

No text.	(3a) The FSB principles on reducing reliance on credit rating agencies ratings state that standard setters and authorities should assess references to credit rating agencies ratings in standards, laws and regulations and, wherever possible, remove them or replace them by suitable alternative standards of creditworthiness. This approach should also be encouraged at Union level. Public authorities should take due account of the need to avoid both excessive and mechanistic reliance on credit ratings by competent authorities and financial market participants and should contribute as appropriate to this objective.'
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Explanation

The proposed amendment reflects the Financial Stability Board (FSB) principle of reducing reliance on credit rating agency (CRA) ratings and proposes that all relevant Union and national public authorities contribute to this objective (see also Amendments 4 and 5).

Amendment 2

Recital 21a of the proposed regulation (new)

No text.	(21a) With the entry into force of Regulation (EU) No xx/201x of the European Parliament and of the Council of xx xxx 201x ⁽²⁾ on prudential requirements for credit institutions and investment firms, credit rating agencies registered or certified in accordance with this Regulation and central banks issuing credit ratings which are exempt from the application of this Regulation will automatically qualify as ECAI for regulatory purposes.'
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Explanation

As regards the interaction between Regulation (EC) No 1060/2009 and the regime for recognition of external credit assessment institutions (ECAIs) under Directive 2006/48/EC, the ECB has already noted that duplication of procedures and costly overlapping requirements should be avoided ⁽³⁾. Recital 44 of Regulation (EC) No 1060/2009 notes that that Regulation should not replace the process of recognising ECAIs under Directive 2006/48/EC. However, since the proposed CRD IV regulation defines ECAIs as all CRAs that have been registered or certified in accordance with Regulation (EC) No 1060/2009 or central banks issuing credit ratings which are exempt from Regulation (EC) No 1060/2009, the ECB recommends already mentioning in a new recital that the above recognition procedure will be obsolete with the entry into force of the proposed CRD IV regulation. In this respect, Article 2(3) of Regulation (EC) No 1060/2009 will need to be amended once the proposed CRD IV regulation is in force.

Amendment 3

Article 1(2a) of the proposed regulation (new)
Amendment to Article 2(4) of Regulation (EC) No 1060/2009

No text.	'4. In order to ensure the uniform application of paragraph 2(d), the Commission may, upon submission
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Text proposed by the Commission	Amendments proposed by the ECB (1)
	<p>of a request by a Member State and after having consulted the ECB and ESMA, in accordance with the regulatory procedure referred to in Article 38(3) and in accordance with paragraph 2(d) of this Article, adopt a decision stating that a central bank falls within the scope of that point and that its credit ratings are therefore exempt from the application of this Regulation and inform ESMA thereof.</p> <p>The Commission ESMA shall publish on its website the list of central banks falling within the scope of paragraph 2(d) of this Article.'</p>

Explanation

When assessing credit standards of eligible assets, the Eurosystem takes into account credit assessments derived from different sources, including in-house credit assessment systems operated by some national central bank (NCBs). These systems are already subject to in-depth validation and comprehensive performance monitoring by the Eurosystem. As regards credit ratings issued by NCBs, in order to benefit from the ECB expertise in the field, the ECB would recommend that the Commission consults the ECB and ESMA before deciding on the exemption.

Pursuant to Article 18(3) of Regulation (EC) No 1060/2009, ESMA publishes on its website a list of CRAs registered in accordance with that Regulation. It is proposed that ESMA also publishes on its website the list of exempted central banks.

Amendment 4

Article 1(6) of the proposed regulation
Amendment to proposed Article 5a of Regulation (EC) No 1060/2009

<p>'Article 5a</p> <p>Over-reliance on credit ratings by financial institutions</p> <p>Credit institutions, investment firms, insurance and reinsurance undertakings, institutions for occupational retirement provisions, management and investment companies, alternative investment fund managers and central counterparties as defined in Regulation (EU) No xx/201x of the European Parliament and of the Council of xx xxx 201x on OTC derivatives, central counterparties and trade repositories⁹ shall make their own credit risk assessment and shall not solely or mechanistically rely on credit ratings for assessing the creditworthiness of an entity or financial instrument. Competent authorities in charge of supervising these undertakings shall closely check the adequacy of undertakings credit assessment processes.'</p>	<p>'Article 5a</p> <p>Over-reliance on credit ratings by financial institutions</p> <p>Credit institutions, investment firms, insurance and reinsurance undertakings, institutions for occupational retirement provisions, management and investment companies, alternative investment fund managers and central counterparties as defined in Regulation (EU) No xx/201x of the European Parliament and of the Council of xx xxx 201x on OTC derivatives, central counterparties and trade repositories⁹ shall develop and apply adequate internal procedures and methodologies to enable them to make their own credit risk assessment in accordance with the specific sectoral rules applying to them and shall not solely or mechanistically rely on credit ratings for assessing the creditworthiness of an entity or financial instrument. Competent authorities in charge of supervising these undertakings shall, taking into account the nature, scale and complexity of an undertaking's activities, closely check the adequacy of undertakings credit assessment processes.'</p>
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Explanation

The rationale for the proposed amendment is set out in paragraphs 1.1 and 1.2 of this Opinion.

Text proposed by the Commission

Amendments proposed by the ECB (1)

Amendment 5

Article 1(6) of the proposed regulation
Amendment to proposed Article 5b of Regulation (EC) No 1060/2009

<p><i>'Article 5b</i></p> <p>Reliance on credit ratings by the European Supervisory Authorities and the European Systemic Risk Board</p> <p>The European Supervisory Authority (European Banking Authority) established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council (*) (EBA), the European Supervisory Authority (European Insurance and Occupational Pensions Authority) established by Regulation (EU) No 1094/2010 of the European Parliament and of the Council (**) (EIOPA) and ESMA shall not refer to credit ratings in their guidelines, recommendations and draft technical standards where such references have the potential to trigger mechanistic reliance on credit ratings by competent authorities or financial market participants. Accordingly, and at the latest by 31 December 2013, EBA, EIOPA and ESMA shall review and remove where appropriate all references to credit ratings in existing guidelines and recommendations.</p> <p>The European Systemic Risk Board (ESRB) established by Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (***) shall not refer to credit ratings in its warnings and recommendations where such references have the potential to trigger mechanistic reliance on credit ratings'.</p>	<p><i>'Article 5b</i></p> <p>Reliance on credit ratings by the European Supervisory Authorities and the European Systemic Risk Board</p> <p>The European Supervisory Authority (European Banking Authority) established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council (*) (EBA), the European Supervisory Authority (European Insurance and Occupational Pensions Authority) established by Regulation (EU) No 1094/2010 of the European Parliament and of the Council (**) (EIOPA) and ESMA shall not refer to credit ratings in their guidelines, recommendations and draft technical standards where such references have the potential to trigger mechanistic reliance on credit ratings by competent authorities or financial market participants. Accordingly, and at the latest by 31 December 2013, EBA, EIOPA and ESMA shall review and remove where appropriate all references to credit ratings in existing guidelines and recommendations.</p> <p>The European Systemic Risk Board (ESRB) established by Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (***) shall not refer to credit ratings in its warnings and recommendations where such references have the potential to trigger mechanistic reliance on credit ratings.'</p>
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Explanation

The rationale for the proposed amendment is set out in paragraphs 1.3 to 1.8 of this Opinion.

Amendment 6

Article 1(14) of the proposed regulation
Amendment to proposed Article 11a of Regulation (EC) No 1060/2009

<p><i>'Article 11a</i></p> <p>European Rating Index</p> <p>1. Any registered and any certified credit rating agency shall, when issuing a credit rating or a rating outlook, submit to ESMA rating information, including the rating and outlook of the rated instrument, information on the type of rating, the type of rating action, and date and hour of publication. The rating submitted shall be based upon the harmonised rating scale referred to in point (a) of Article 21(4a).</p> <p>2. ESMA shall establish a European Rating Index which will include all credit ratings submitted to ESMA</p>	<p><i>'Article 11a</i></p> <p>European rating index platform</p> <p>1. Any registered and any certified credit rating agency shall, when issuing a credit rating or a rating outlook, submit to ESMA rating information, including the rating and outlook of the rated instrument, information on the type of rating, the type of rating action, and date and hour of publication. The rating submitted shall be based upon the harmonised rating scale referred to in point (a) of Article 21(4a).</p> <p>2. ESMA shall establish a European rating index platform which will include all credit ratings submitted</p>
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Text proposed by the Commission	Amendments proposed by the ECB ⁽¹⁾
pursuant to paragraph 1 and an aggregated rating index for any rated debt instrument. The index and individual credit ratings shall be published on ESMA's website.'	to ESMA pursuant to paragraph 1 and an aggregated rating index for any rated debt instrument . The index and individual credit ratings shall be published on ESMA's website.'

Explanation

The rationale for the proposed amendment is set out in paragraphs 2.3 to 2.5 of this Opinion. The title of the Article is modified accordingly.

Amendment 7

Article 1(18)(b) of the proposed regulation
Amendment to proposed Article 21(4a) of Regulation (EC) No 1060/2009

'4a. ESMA shall develop draft regulatory technical standards to specify: (a) a harmonised standard rating scale to be used, in accordance with Article 11a, by registered and certified credit rating agencies, which will be based upon the metric to measure credit risk and the number of rating categories and cut off values for each rating category; [...].'	'4a. ESMA shall develop draft regulatory technical standards to specify: (a) a harmonised standard rating scale to be used, in accordance with Article 11a, by registered and certified credit rating agencies, which will be based upon the metric to measure credit risk and the number of rating categories and cut off values for each rating category; [...].'
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Explanation

The rationale for the proposed amendment is set out in paragraphs 2.3 to 2.5 of this Opinion.

Amendment 8

Article 1(18)(ba) of the proposed regulation (new)
Article 21(4b) of Regulation (EC) No 1060/2009 (new)

No text.	'4b. By 31 December 2015, ESMA, in cooperation with EBA, EIOPA and the ECB shall review the feasibility of establishing a harmonised rating scale for ratings issued by registered and certified credit rating agencies and report to the Commission. '
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Explanation

The rationale for the proposed amendment is set out in paragraphs 2.3 to 2.5 of this Opinion.

Amendment 9

Article 1(24)(c) of the proposed regulation (new)
Article 39(5) of Regulation (EC) No 1060/2009 (new)

No text.	'5. By 31 December 2014, ESMA, EBA and EIOPA shall report to the Commission on the application of the measures taken to reduce excessive reliance on external credit ratings and assess options for possible alternatives or complements to the existing models. The ECB and the European Systemic Risk Board, as regards macro-prudential and systemic risk aspects, shall contribute to this report. '
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Explanation

The rationale for the proposed amendment is set out in paragraphs 2.3 to 2.8 of this Opinion.

⁽¹⁾ Bold in the body of the text indicates where the European Central Bank (ECB) proposes inserting new text. Strikethrough in the body of the text indicates where the ECB proposes deleting text.

⁽²⁾ OJ L ..., p.

⁽³⁾ Paragraph 8 of Opinion CON/2009/38.

ANNEX II

THE EUROSISTEM CREDIT ASSESSMENT FRAMEWORK

1. The ECB is directly concerned with the services provided by CRAs in the context of Eurosystem tasks and obligations, notably with regard to the conduct of monetary policy operations. Without prejudice to Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies⁽¹⁾, the Eurosystem and the national central banks (NCBs) of Member States whose currency is not the euro define the procedures, rules and criteria necessary to ensure that the requirement of high credit standards for eligible assets for monetary policy operations is met and determine, as appropriate, the conditions for the use of credit ratings in central bank operations⁽²⁾.
2. The Eurosystem credit assessment framework (ECAAF) takes account of credit assessments from one of four sources: External Credit Assessment Institutions (ECAIs); in-house credit assessment systems (ICAS) of NCBs; counterparties' internal ratings-based systems; or third party providers' rating tools. These systems and tools are subject to general acceptance criteria, which are complemented by a multi-annual performance monitoring process in accordance with the Eurosystem legal framework on monetary policy instruments and procedures⁽³⁾. Additionally, the Eurosystem takes into account institutional criteria and features guaranteeing similar protection for instrument holders, such as guarantees. The ECAAF performance monitoring process consists of an annual *ex post* comparison of the observed default rate for the set of all eligible debtors, i.e. the static pool, and the credit quality threshold of the Eurosystem given by the 'probability of default' benchmark⁽⁴⁾ and determines the maximum level of credit risk that the Eurosystem is willing to assume in its standard monetary policy operations. The performance monitoring process is aimed at ensuring that credit assessment results are comparable across systems and sources. At the same time, the Eurosystem exercises judgment with regard to these assessments and reserves the right to reject or limit the use of an asset on the basis of any information on its credit quality that it may consider relevant.
3. As part of the measures announced in December 2011 in support of bank lending and money market activities⁽⁵⁾, the Governing Council indicated that credit claims, i.e. bank loans, should be made eligible on a wider basis. Furthermore, the Governing Council welcomed the wider use of credit claims as collateral in Eurosystem credit operations on the basis of harmonised criteria and announced that the Eurosystem is strengthening its internal credit assessment capabilities. It also encourages potential external credit assessment providers, i.e. rating agencies and providers of rating tools, and commercial banks using an internal ratings-based system, to seek Eurosystem endorsement under the ECAAF⁽⁶⁾. Furthermore, the ECB and, in particular, Eurosystem NCBs (since information on credit claim counterparties is available at national level), need to have adequate internal credit assessment systems in place. It will therefore be necessary for Eurosystem NCBs to strengthen their ability to assess credits that are not rated by CRAs. Currently, there are four NCBs that have internal rating systems in place⁽⁷⁾. These systems are already subject to in-depth validation and comprehensive performance monitoring by the Eurosystem.
4. With regard to sovereign ratings, the Eurosystem has proven its independence from CRAs and made its own judgement on the credit quality of sovereign bonds as regards their eligibility as collateral for Eurosystem liquidity operations, by deciding to suspend the rating requirements for euro area Member States under an economic and financial adjustment programme agreed with the European Union, the International Monetary Fund and the ECB in the cases of Greece⁽⁸⁾, Ireland⁽⁹⁾ and Portugal⁽¹⁰⁾, and by deciding to end such suspension upon assessing the negative effect on the credit quality of its sovereign bonds of the decision by Greece to launch a debt exchange offer to bondholders⁽¹¹⁾.

⁽¹⁾ OJ L 302, 17.11.2009, p. 1.

⁽²⁾ See Opinion CON/2009/38 of 21 April 2009 on a proposal for a regulation of the European Parliament and of the Council on credit rating agencies, Amendment 1.

⁽³⁾ Guideline ECB/2011/14 of 20 September 2011 on monetary policy instruments and procedures of the Eurosystem (OJ L 331, 14.12.2011, p. 1).

⁽⁴⁾ See Section 6.3.5 of Annex I to Guideline ECB/2011/14.

⁽⁵⁾ See the ECB's press release of 8 December 2011, available on the ECB's website at: <http://www.ecb.europa.eu>

⁽⁶⁾ See Section 6.3.4 of Annex I to Guideline ECB/2011/14.

⁽⁷⁾ The ICAS source currently consists of the four credit assessment systems managed by the Deutsche Bundesbank, the Banco de España, the Banque de France and the Oesterreichische Nationalbank (see Section 6.3.4.2 of Annex I to Guideline ECB/2011/14).

⁽⁸⁾ Decision ECB/2010/3 of 6 May 2010 on temporary measures relating to the eligibility of marketable debt instruments issued or guaranteed by the Greek Government (OJ L 117, 11.5.2010, p. 102).

⁽⁹⁾ Decision ECB/2011/4 of 31 March 2011 on temporary measures relating to the eligibility of marketable debt instruments issued or guaranteed by the Irish Government (OJ L 94, 8.4.2011, p. 33).

⁽¹⁰⁾ Decision ECB/2011/10 of 7 July 2011 on temporary measures relating to the eligibility of marketable debt instruments issued or guaranteed by the Portuguese Government (OJ L 182, 12.7.2011, p. 31).

⁽¹¹⁾ Decision ECB/2012/2 of 27 February 2012 repealing Decision ECB/2010/3 on temporary measures relating to the eligibility of marketable debt instruments issued or guaranteed by the Greek Government (OJ L 59, 1.3.2012, p. 36).

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5. Against this background, the Eurosystem complies with the FSB principle under which central banks should reach their own credit judgements on the financial instruments that they accept in market operations, both as collateral and as outright purchases, and under which central bank policies should avoid mechanistic approaches that could lead to unnecessarily abrupt and large changes in the eligibility of financial instruments and the level of haircuts that may exacerbate cliff effects ⁽¹⁾. At the same time, as indicated above, the Eurosystem is prepared to continuously review ECAF procedures, rules, methods, systems in general and resources used by in-house credit rating sources.

⁽¹⁾ FSB principles, Principle III.1., Central bank operations.