

## I

(Resolutions, recommendations and opinions)

## OPINIONS

## EUROPEAN CENTRAL BANK

## OPINION OF THE EUROPEAN CENTRAL BANK

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

(CON/2010/82)

(2010/C 337/01)

**Introduction and legal basis**

On 26 July 2010, the European Central Bank (ECB) received a request from the Council of the European Union for an opinion on a proposal for a regulation amending Regulation (EC) No 1060/2009 on credit rating agencies <sup>(1)</sup> (hereinafter the 'proposed regulation').

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 contains provisions affecting the European System of Central Banks' (ESCBs') 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**

1. The ECB broadly welcomes the measures introduced by the proposed regulation with a view to strengthening the regulatory framework of credit rating agencies (CRAs), in particular with a view to: (a) attributing comprehensive powers to the European Securities and Markets Authority (ESMA) as regards the registration and surveillance of CRAs; and (b) introducing increased transparency and competition in the market for ratings of structured finance instruments. The ECB appreciates that Regulation (EC) No 1060/2009 <sup>(2)</sup> incorporated many of the observations previously made in: (a) the Eurosystem's contribution to the public consultation on the Commission's draft directive/regulation on credit rating agencies <sup>(3)</sup>; and (b) ECB 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 <sup>(4)</sup>.
2. As noted in the 2008 Eurosystem's contribution <sup>(5)</sup>, a single entity approach to supervision of CRAs is preferable to dispersed supervision from the perspective of ensuring coordination and a level playing

<sup>(1)</sup> COM(2010) 289 final.

<sup>(2)</sup> OJ L 302, 17.11.2009, p. 1.

<sup>(3)</sup> September 2008 (hereinafter the '2008 Eurosystem's contribution'), available on the ECB's website at <http://www.ecb.europa.eu>

<sup>(4)</sup> OJ C 115, 20.5.2009, p. 1.

<sup>(5)</sup> P. 4.

field. In this context, the ECB welcomes the attribution to ESMA of a number of tasks related to the registration and surveillance of CRAs. The ECB understands that the regulatory framework will preserve the national supervisory authorities' right to recognise CRAs as external credit assessment institutions under Articles 81 to 83 of 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 (recast) <sup>(1)</sup>.

3. The ECB broadly supports, subject to further observations below, the transparency arrangements set out in the proposed new Articles 8a and 8b of Regulation (EC) No 1060/2009 <sup>(2)</sup> which require issuers of structured finance instruments to grant access to the information which they provide to their appointed CRA also to certain other CRAs. The introduction of such disclosure requirements aims to enhance the quality and transparency of the rating process for structured finance instruments, and might also contribute to increased competition between CRAs. Further, the new requirements are to a certain extent similar to the rules applied by the US Securities and Exchange Commission (SEC) since June 2010 <sup>(3)</sup>. Convergence between the EU and US regulatory frameworks, when possible, constitutes an important aspect of a level playing field.

However, the ECB wishes to point out certain potential concerns related to the implementation of the new disclosure requirements. First, under the proposed arrangements, the CRA appointed to issue a credit rating in a given case is expected to be subject to increased competition from other eligible CRAs (non-appointed CRAs). Specifically, it may be easier for non-appointed CRAs to issue unsolicited credit ratings, since they will be given access to information provided by the issuer to the appointed CRA. However, there may be considerable barriers to market entry for the non-appointed CRAs related to: (a) the statutory eligibility criteria for access to the issuer's information; and (b) informal knowledge available to the appointed CRA as a result of its long-standing relations with the issuer. Indeed, experience with the transparency rules introduced by the SEC has not yet conclusively confirmed that such rules have a substantive effect on CRA practices, in particular by increasing the number of unsolicited credit ratings. Second, the possibility of obtaining multiple credit ratings could allow issuers to select the most favourable one ('rating shopping'), which might lead to competition between CRAs for provision of the most attractive ratings. This might negatively impact the quality of the ratings issued. Third, the situation of the issuer itself will also need to be examined, taking into account such elements as: (a) the burden related to allowing information access for non-appointed CRAs; and (b) protection against any potential misuse of the information received by the non-appointed CRA.

The ECB understands that the transparency arrangements set out in the proposed new Articles 8a and 8b have received broad support in the context of the preparatory work on the proposed regulation <sup>(4)</sup>. Hence, the ECB proposes only limited amendments <sup>(5)</sup>. At the same time, it recommends that developments in the abovementioned areas should be closely monitored by ESMA in connection with the implementation of the proposed regulation, so that appropriate adjustments may be put forward by the Commission in view of the experience gained <sup>(6)</sup>.

4. Moreover, the ECB expects that work on the further-reaching transparency arrangements related to issuance of credit ratings will be undertaken by the Commission on the basis of the experience acquired with the rules introduced by the proposed regulation. To achieve the desired effect, the transparency arrangements should balance, on the one hand, the business interests of the issuers providing sensitive information to the CRAs and, on the other, the needs of central banks, supervisors and other stakeholders for wider access to information allowing independent assessment of the CRAs' performance.

<sup>(1)</sup> OJ L 177, 30.6.2006, p. 1.

<sup>(2)</sup> See Article 1(4) of the proposed regulation.

<sup>(3)</sup> See the amendment to Rule 17g-5 of Part 240 of the Securities Exchange Act 1934, SEC Release No 34-61050 (23 November 2009), Federal Register Vol. 74, No 232, p. 63832 (4 December 2009) (hereinafter the 'amended SEC rule 240.17g-5'); available on the SEC website at <http://www.sec.gov> The amended SEC rule 240.17g-5 applies to US issuers as of 2 June 2010 and will apply to non-US issuers appointing a US-based CRA as of 2 December 2010; see also the SEC's 'Order of 19 May 2010 granting temporary conditional exemption for nationally recognised statistical rating organisations from the requirements of rule 17g-5 under the Securities Exchange Act of 1934 and request for comment' (Release No 34-62120), available on the SEC website).

<sup>(4)</sup> Compare the current wording of the proposed regulation with that of the Presidency compromise proposal of 7 October 2010, 2010/0160 (COD), p. 17.

<sup>(5)</sup> See further comments in paragraph 5.

<sup>(6)</sup> See further comments in paragraph 6.

All of the above elements are particularly relevant in the securitisation market. In this respect, the Eurosystem aims to access, as part of its framework for the evaluation of collateral, the loan-by-loan information allowing the ongoing assessment of risks for securitised instruments.

### Specific observations

#### *Increased transparency of the rating process*

5. The proposed regulation requires that each appointed CRA delivers to its competitors a list of the structured finance instruments currently being rated by it, together with a link to the website where the issuer stores the information used in the preparation of credit ratings. Non-appointed CRAs may obtain access to this information, provided that: (a) at the time of request, they have the systems and organisational structure in place to protect the confidentiality of such information; and (b) after they have accessed the information, they issue ratings on a yearly basis for at least 10 % of the structured finance instruments for which the information has been requested <sup>(1)</sup>. The ECB recommends that the proposed regulation defines more clearly, first, the method of verification by ESMA of compliance with these criteria, second, the calculation method applied for verifying compliance with the second criterion <sup>(2)</sup> and, third, the situations in which non-compliance with the second criterion could lead to the imposition of sanctions <sup>(3)</sup>.
6. Moreover, the ECB makes the following recommendations with a view to addressing the issues specified in paragraph 3.

First, CRAs should be required to report every six months to ESMA data on the number of credit ratings which they have issued in a given period, breaking this down to show: (a) credit ratings requested by a rated entity or a related third party; and (b) unsolicited credit ratings, together with data indicating the proportion of such unsolicited credit ratings which were higher, equal to, or lower than the relevant credit ratings issued by the relevant appointed CRA. Such reporting should be included in periodic disclosures made by CRAs to ESMA <sup>(4)</sup>.

Second, ESMA should be mandated to monitor the implementation of the proposed new Articles 8a and 8b with a view to identifying: (a) the impact of these provisions on the amount and quality of issued credit ratings, including unsolicited credit ratings; (b) any possible need to amend the eligibility criteria for non-appointed CRAs, with a view to avoiding excessive barriers to market entry; (c) the burden imposed on issuers; and (d) any possible need to protect issuers against misuse of the information provided by them to non-appointed CRAs. A report by ESMA should be the basis for the Commission's review of the proposed Articles 8a and 8b in the specified period after their entry into force.

#### *Provision of information to ESMA and the Eurosystem*

7. The ECB notes that CRAs will be required to provide their historical performance data to a central repository established by ESMA <sup>(5)</sup>. The ECB recommends that these data should be in a comparable format, and consistent with the Union statistical framework. Common identifiers and standards should be used as much as possible in the structuring and storage of the data (e.g., through the use of standardised reference information such as ISIN codes).
8. Moreover, as was highlighted in the 2008 Eurosystem's contribution, the new framework for regulating CRAs should allow for an appropriate level of cooperation between supervisory authorities and the

<sup>(1)</sup> See the proposed new Article 8a(2) of Regulation (EC) No 1060/2009.

<sup>(2)</sup> Compare the current drafting with Section (a)(3)(iii)(B)(1) of the amended SEC rule 240.17g-5.

<sup>(3)</sup> See the proposed new Articles 24(1) and 36a(1) of Regulation (EC) No 1060/2009, together with the proposed Section I(w) of Annex III to Regulation (EC) No 1060/2009.

<sup>(4)</sup> See the proposed new Article 11(3) of Regulation (EC) No 1060/2009, together with Part II, Section E of Annex I to Regulation (EC) No 1060/2009.

<sup>(5)</sup> See the proposed new Article 11(2) of Regulation (EC) No 1060/2009.

Eurosystem. The Eurosystem has a keen interest in the area of credit ratings, related to its financial stability role. Furthermore, a Eurosystem-wide framework for monitoring CRAs in the context of monetary policy operations is already in place<sup>(1)</sup>. Hence, the ECB appreciates the arrangements for the exchange of information set out in the proposed new Article 27 of Regulation (EC) No 1060/2009. Nevertheless, the ECB recommends that this provision should expressly ensure the access by the ESCB and the ECB, as well as the specified Member State authorities, to the information relevant for the exercise of their statutory tasks.

### **Drafting proposals**

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

Done at Frankfurt am Main, 19 November 2010.

*The President of the ECB*  
Jean-Claude TRICHET

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<sup>(1)</sup> See the 2008 Eurosystem's contribution, p. 5 and Section 6.3 ('Eurosystem credit assessment framework') of Annex I to Guideline ECB/2000/7 of 31 August 2000 on monetary policy instruments and procedures of the Eurosystem, OJ L 310, 11.12.2000, p. 1.

## ANNEX

## Drafting proposals

Text proposed by the Commission	Amendments proposed by the ECB <sup>(1)</sup>
<b>Amendment 1</b>	
Third citation (new)	
No text.	<b>'Having regard to the opinion of the European Central Bank,'</b>

## Justification

Since the ECB is required to be consulted on the proposed regulation under Articles 127(4) and 282(5) of the Treaty, a citation to this effect should be inserted in the proposed regulation in line with the second paragraph of Article 296 of the Treaty, according to which legal acts shall refer, inter alia, to opinions required by the Treaties.

## Amendment 2

Recital 5, recitals 11a and 16a (new)

<p>(5) In order to reinforce competition between credit rating agencies, to help avoiding possible conflicts of interest under the issuer-pays model, which are particularly virulent regarding the rating of structured finance instruments, and to enhance transparency and the quality of ratings for structured finance instruments, registered or certified credit rating agencies should have the right to access a list of structured finance instruments that are being rated by their competitors. The information for this rating should be provided by the issuer or a related third party for the purpose of the issuance of unsolicited competing ratings on structured finance instruments. The issuance of such unsolicited ratings should promote the use of more than one rating per structured finance instrument. Access to the websites should only be granted if a credit rating agency is able to ensure the confidentiality of the requested information.'</p>	<p><del>(5) In order to reinforce competition between credit rating agencies, to help avoiding possible</del> <b>Rating of structured finance instruments may be particularly affected by</b> conflicts of interest <del>under related to</del> the issuer-pays model, <del>which are particularly virulent regarding the rating of structured finance instruments.</del> <b>In order to address this issue, competition between credit rating agencies should be reinforced through creation of incentives to use multiple credit ratings and hence to enhance transparency and the quality of the ratings process. for structured finance instruments.</b> <b>Hence,</b> registered or certified credit rating agencies should have the right to access a list of structured finance instruments that are being rated by their competitors. The information for this rating should be provided by the issuer or a related third party for the purpose of the issuance of unsolicited competing ratings on structured finance instruments. <del>The issuance of such unsolicited ratings should promote the use of more than one rating per structured finance instrument.</del> Access to the websites should only be granted if a credit rating agency is able to ensure the confidentiality of the requested information. <b>ESMA should be mandated to monitor the implementation of such transparency arrangements and to draw up a report analysing their practical impact on the practice of issuing credit ratings and the need for any adjustments.</b></p> <p>...</p>
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Text proposed by the Commission	Amendments proposed by the ECB (1)
	<p>(11a) <b>In order to allow effective surveillance by ESMA, credit rating agencies should make available in a central repository established by ESMA information on their historical performance data. This should be in a format which is consistent with the Union statistical framework and which facilitates direct comparisons between historical data provided by different credit rating agencies. Moreover, in order to safeguard the proper functioning of the practice of issuing unsolicited credit ratings, periodic disclosures made by credit rating agencies to ESMA should include specified information related to the issuance of such ratings.</b></p> <p>...</p> <p>(16a) <b>Competent supervisory authorities, central banks of Member States, the European System of Central Banks and the European Central Bank, in their capacity as monetary authorities, the European Systemic Risk Board and, where appropriate, other Member State authorities responsible for overseeing payment and settlement systems, should have access to the information which has been collected by ESMA from credit rating agencies which is relevant for the exercise of their tasks.'</b></p>

*Justification*

See paragraphs 5 to 8 of the opinion. These amendments are related to amendments 3 to 7.

**Amendment 3**

Article 1(4) of the proposed regulation

<p>'4. The following Articles 8a and 8b are inserted:</p> <p style="text-align: center;"><i>"Article 8a</i></p> <p style="text-align: center;"><i>Information on structured finance instruments</i></p> <p>...</p> <p>2. Where other credit rating agencies registered or certified according to this Regulation request access to the information referred to in paragraph 1, they shall be granted access without delay provided that they meet all of the following conditions:</p> <p>(a) they have the systems and organisational structure in place to ensure the confidentiality of this information;</p> <p>(b) they provide ratings on a yearly basis for at least 10 % of the structured finance instruments for which they request access to information referred to in paragraph 1.</p> <p>...''</p>	<p>'4. The following Articles 8a, 8b <b>and 8c</b> are inserted:</p> <p style="text-align: center;"><i>"Article 8a</i></p> <p style="text-align: center;"><i>Information on structured finance instruments</i></p> <p>...</p> <p>2. Where other credit rating agencies registered or certified <b>in accordance with</b> this Regulation request access to the information referred to in paragraph 1, they shall be granted access without delay provided that they <b>have been granted the authorisation referred to in paragraph 2b.</b><del>meet all of the following conditions:</del></p> <p><del>(a) they have the systems and organisational structure in place to ensure the confidentiality of this information;</del></p> <p><del>(b) they provide ratings on a yearly basis for at least 10 % of the structured finance instruments for which they request access to information referred to in paragraph 1.</del></p>
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Text proposed by the Commission	Amendments proposed by the ECB <sup>(1)</sup>
	<p>2a. A credit rating agency which, in accordance with paragraph 2, accesses the information referred to in paragraph 1 for more than 10 structured finance instruments within one calendar year shall issue, within the same calendar year, credit ratings in respect of at least 10 % of the structured finance instruments in respect of which it accessed the information.</p> <p>2b. ESMA shall verify on a yearly basis whether the credit rating agencies registered or certified in accordance with this Regulation comply with the following conditions:</p> <p>(a) having systems and organisational structures in place to ensure the confidentiality of the information referred to in paragraph 1; and</p> <p>(b) complying, in the previous calendar year, with the obligation specified in paragraph 2a.</p> <p>If the outcome of the verification is positive, ESMA shall issue an authorisation allowing access to the information referred to in paragraph 1, which shall be valid for a period of 12 months.</p> <p>...</p> <p style="text-align: center;"><i>Article 8c</i></p> <p style="text-align: center;"><i>Review</i></p> <p>1. Before 1 April 2012, ESMA shall draw up a report analysing the experience acquired in connection with the application of Articles 8a and 8b. The report shall in particular address the following issues: (a) the impact of those Articles on the amount and quality of issued credit ratings, including unsolicited credit ratings; (b) any need to amend the eligibility conditions set by Article 8a(2), with a view to avoiding excessive barriers to market entry; (c) the burden imposed on issuers by Article 8a(1); and (d) any need to protect issuers against misuse of the information provided by them to a credit rating agency other than the credit rating agency that they appointed.</p> <p>2. Following the submission by ESMA of the report referred to in paragraph 1, the Commission shall, if appropriate, put forward proposals to amend Articles 8a and 8b.”</p>

*Justification*

See paragraphs 5 to 6 of the opinion.

**Amendment 4**

Article 1(7) of the proposed regulation

‘7. In Article 11, paragraphs 2 and 3 are replaced by the following:

‘7. In Article 11, paragraphs 2 and 3 are replaced by the following:



Text proposed by the Commission	Amendments proposed by the ECB <sup>(1)</sup>
No text.	<p><b>‘3. In Part II of Section E, point 1 is replaced by the following:</b></p> <p><b>“1. every six months:</b></p> <p><b>(a) data about the historical default rates of its rating categories, distinguishing between the main geographical areas of the issuers and whether the default rates of these categories have changed over time; and</b></p> <p><b>(b) data on the number of the credit ratings which it has issued in a given reporting period, broken down to show: (i) credit ratings requested by a rated entity or a related third party; and (ii) unsolicited credit ratings, together with data indicating the proportion of such unsolicited credit ratings which were higher, equal to, or lower than the relevant credit ratings issued by the credit rating agency appointed by a rated entity or a related third party.”</b></p> <p>...’</p>

Justification

See paragraph 6 of the opinion.

#### Amendment 7

Annex II to the proposed regulation

<p>The following Annex III is added to Regulation (EC) No 1060/2009:</p> <p>“ANNEX III</p> <p>SANCTIONS</p> <p>Breaches</p> <p>I. <i>Breaches related to conflicts of interest, organisational or operational requirements</i></p> <p>...</p> <p>(w) The CRA infringes Article 8a(2)(b) where it fails to provide, on a yearly basis, ratings for at least 10 % of the structured finance instruments for which it has requested access to the information on the website provided by the issuer or related third party.</p> <p>...”’</p>	<p>The following Annex III is added to Regulation (EC) No 1060/2009:</p> <p>“ANNEX III</p> <p>SANCTIONS</p> <p>Breaches</p> <p>I. <i>Breaches related to conflicts of interest, organisational or operational requirements</i></p> <p>...</p> <p>(w) The CRA infringes Article 8a(2)(b) where <del>it fails to provide, on a yearly basis in a given calendar year it</del> <b>accessed the information on more than 10 structured finance instruments on a website or websites provided pursuant to Article 8a(2) but failed to issue credit</b> ratings for at least 10 % of the structured finance instruments for which it <del>has requested access to the such information on the website provided by the issuer or related third party.</del></p> <p>...”’</p>
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Justification

See paragraph 5 of the opinion.

<sup>(1)</sup> Bold in the body of the text indicates where the ECB proposes inserting new text. Strikethrough in the body of the text indicates where the ECB proposes deleting text.