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Business Information Industry Association Asia Pacific – Middle East

BIIA News Flash!

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European Commission Proposal on Regulating Credit Rating Agencies

The European Commission has put forward a proposal for a Regulation on credit rating agencies. This proposal is part of a package of proposals to deal with the financial crisis and adds to Commission's proposals on Solvency II, Capital Requirements Directive, Deposit Guarantee Schemes and accounting. The new rules are designed to ensure high quality credit ratings which are not tainted by the conflicts of interest which are inherent to the ratings business.

Internal Market and Services Commissioner Charlie McCreevy said: "I want Europe to adopt a leading role in this area. Our proposal goes further than the rules which apply in other jurisdictions. These very exacting rules are necessary to restore the confidence of the market in the ratings business in the European Union "

The proposal lays down conditions for the issuance of credit ratings which are needed to restore market confidence and increase investor protection. It introduces a registration procedure for credit rating agencies to enable European supervisors to control the activities of rating agencies whose ratings are used by credit institutions, investment firms, insurance, assurance and reinsurance undertakings, collective investment schemes and pension funds within the Community.

Credit rating agencies will have to comply with rigorous rules to make sure (i) that ratings are not affected by conflicts of interest, (ii) that credit rating agencies remain vigilant on the quality of the rating methodology and the ratings and (iii) that credit rating agencies act in a transparent manner. The proposal also includes an effective surveillance regime whereby European regulators will supervise credit rating agencies.

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New rules include the following:

- Credit rating agencies may not provide advisory services.
- They will not be allowed to rate financial instruments if they do not have sufficient quality information to base their ratings on
- They must disclose the models, methodologies and key assumptions on which they base their ratings
- They will be obliged to publish an annual transparency report
- They will have to create an internal function to review the quality of their ratings
- They should have at least three independent directors on their boards whose remuneration cannot depend on the business performance of the rating agency. They will be appointed for a single term of office which can be no longer than five years. They can only be dismissed in case of professional misconduct. At least one of them should be an expert in securitization and structured finance.

Some of the proposed rules are based on the standards set in the International Organisation of Securities Commissions (IOSCO) code. The proposal gives those rules a legally binding character. Also, in those cases where the IOSCO standards are not sufficient to restore market confidence and ensure investor protection the Commission has proposed stricter rules.

The Commission started work to propose legislation in this area in the summer of 2007 when there were first indications of malpractice in the ratings business. This proposal is the outcome a thorough and comprehensive impact assessment as well as extensive consultations. Important input has been given by the Committee of European Securities Regulators and the European Securities Markets Expert Group, Member States, the ECB, major credit rating agencies and other stakeholders (industry associations from the insurance, securities and banking sectors, information providers, etc.).

Background

In October 2007 EU Finance Ministers agreed to a set of conclusions on the crisis (the 'Ecofin Roadmap') which included a proposal to assess the role played by credit rating agencies and to address any relevant deficiencies. The EU Council of 20 June and 16 October 2008 called for a legislative proposal to strengthen the rules on credit rating agencies and their supervision at EU level, considering it a priority to restore confidence and proper functioning of the financial sector.

The proposal is available at: http://ec.europa.eu/internal_market/securities/agencies/index_en.htm

Courtesy: Standard & Poor's, a member of BIIA

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