



EUROPEAN COMMISSION
Directorate General Internal Market and Services

CAPITAL AND COMPANIES

Brussels, **08 MAI 2013**
MARKT/F4 PC/cv (2013) 1129724

Ms Elizabeth M. Murphy
Secretary
Securities and Exchange
Commission
100 F Street, N.E.
Washington D.C. 20549-1090
United States

Subject: Credit rating agencies roundtable, File Number 4-661

Dear Ms Murphy,

I welcome your efforts to further implement the Dodd-Frank Wall Street Reform and the Consumer Protection Act to strengthen the regulation on credit rating agencies. I believe that the forthcoming roundtable will play an important role in this direction.

In the European Union, the legislative framework was recently strengthened by a revision of the Regulation on Credit Rating Agencies, which will enter into force mid-2013. The revised Regulation covers a wide range of the issues that will be addressed at the roundtable. The new rules in the EU aim to reduce reliance on credit ratings, improve the transparency of sovereign debt, introduce a civil liability regime, enhance diversity in the rating industry and address conflicts of interests due to the issuer's pays model.

Next week's roundtable will precisely address the potential conflicts of interest due to the issuers pay's model. The Commission carefully assessed this issue when preparing the latest revision of the CRA Regulation and a Credit Rating Assignment System policy option was not retained. Instead, the European Commission proposed a range of policy measures which complement and reinforce each other to achieve the intended policy objectives. With regard to Rule 17g-5, the European Commission favours all efforts to promote unsolicited credit rating of structured finance instruments. To this end, the European Parliament and Council have adopted key measures which will allow for disclosure of underlying assets not only to credit rating agencies but to all investors.

1. CREDIT RATING ASSIGNMENT SYSTEM

The establishment of a *Credit Rating Assignment System* was carefully examined within the impact assessment¹ accompanying our legislative proposal. We consider that a credit

¹ Accompanying the proposal COM 2011 (746) final

rating assignment process could effectively reduce such conflicts of interest and reduce the risks of rating shopping by issuers.

However, the introduction of such a system would be an important market intervention and could entail important risks which have to be carefully assessed. The European Commission considered that the effective functioning of the rating market requires that securities issuers are free to choose their rating provider. If ratings are centrally allocated, incentives for credit rating agencies to maximise their operational performance and to compete on the basis of price and service quality could significantly be reduced. It could be difficult to determine the appropriate criteria for attributing rating mandates to individual credit rating agencies. The selecting board could be exposed to civil liability claims. In addition, the establishment and the administration of such a board would be costly and require taxpayers' money.

To this end the European Commission did at this stage not withhold this policy measure. Instead, it presented an alternative package of policy measures to address these conflicts of interest.

2. RULE 17 G-5

The European Commission supports the main objective of Rule 17g-5 to encourage unsolicited ratings of asset-backed securities. Unsolicited credit ratings are not constrained by the issuer-pays model and therefore are theoretically less affected by potential conflicts of interest. Thus, the revised Regulation establishes a general obligation for the issuers, the originators and the sponsors of a structured finance instrument established in the EU to publish jointly information on the website set up by European Securities and Markets Authority (ESMA). This obligation encompasses information on the credit quality and performance of the underlying assets of the structured finance instrument, the structure of the securitization transaction, the cash flows and any collateral supporting a securitisation exposure as well as any information that is necessary to conduct comprehensive and well-informed stress tests on the cash flows and collateral values supporting the underlying exposures.

This measure aims at providing investors with information on structured finance instrument on an on-going basis, and in particular information on the performance of the underlying asset pool. This would enable financial firms and institutional investors to conduct their own due diligence, assess the credit/market risk of a structured finance instrument by themselves and, as a consequence, reduce their reliance on external credit ratings. This measure also aims at encouraging unsolicited ratings by creating opportunities to other credit rating agencies (not mandated by the issuer) to be in a position to provide unsolicited ratings based on publicly available information.

With regard to civil liability issues, the EU CRA Regulation civil liability rules apply to all type of credit ratings, regardless their nature (solicited or unsolicited). A credit rating agency can be held liable for damages caused by an infringement of the legislative framework intentionally or with gross negligence which had an impact on the rating outcome, whether the rating was solicited or not. Moreover, the EU CRA Regulation requires credit rating agencies to comply with rigorous rules of conduct in order to mitigate possible conflicts of interest, ensure high quality and sufficient transparency of ratings and the rating process. Thus, the Commission believes that the civil liability rules would not penalise the issuance of unsolicited credit ratings.

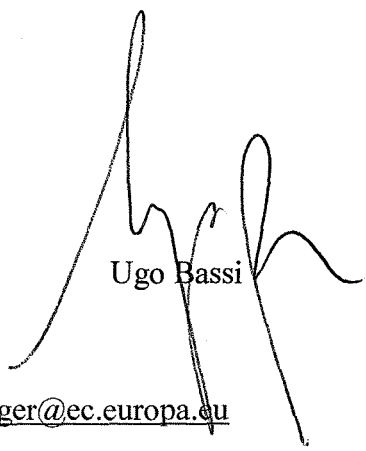
3. ALTERNATIVE COMPENSATION MODELS

With regard to *alternative compensation models*, the third topic covered by the roundtable, a wide range of policy measures were introduced in the new legislation to mitigate conflicts of interest due to the issuer-pays' model.

In this regard, the principle of rotation was introduced for a specific segment of structured finance instruments (re-securitisations). Furthermore, the Commission will further assess the need for extending rotation to other debt instruments. In addition, issuers employing more than one credit rating agency will be required to use a small or medium-sized credit rating agency, on a "*comply or explain*" basis. A new European Credit Rating Platform, which will disclose all available credit ratings at a central website by the European Securities and Markets Authority (ESMA), will increase the visibility of all available credit ratings, enhancing transparency and comparability for investors. In addition, credit rating agencies will be required to charge fees which are non-discriminatory and cost-based. Risks of conflicts of interests are also addressed by introducing shareholder limitations restricting CRAs to rate their own shareholders and to hold important shareholdings in more than one rating agency. Finally, with regard to the "rating shopping", the Regulation requires CRAs to disclose, on an on-going basis, information about all structured finance products submitted to it for their initial review or for preliminary rating. Such disclosure shall be made whether or not issuers contract with the credit rating agency for a final rating.

I hope that this contribution will provide participants with useful information on the regulatory European approach to credit rating agencies. My services remain at your disposal for any additional information.

Yours sincerely,



Ugo Bassi

Contact:

Nathalie Berger, Tel: +32-2-29 96503, Nathalie.berger@ec.europa.eu