The Regulation of Rating Agencies in Europe

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1. Introduction

"Off with their heads!"
– *The Queen of Hearts, Alice in Wonderland*

Before the recent financial crises brought to light their influence on the markets, rating agencies were sheltered from the public eye, known practically only to professionals or informed non-professionals in financial circles and only making their presence felt occasionally.

Nevertheless, rating agencies, in particular the triumvirate of Fitch, Moody's and Standard & Poor's (S&P), have carved out for themselves over the years a key – some would say reference – position on the financial markets, due to the importance, accorded their ratings. Indeed, their "opinions" make it possible for certain institutional investors to acquire a given debt and can trigger acceleration clauses in loan agreements. Over their seventy years of existence, rating agencies have forged an image for themselves of an impartial arbiter of the markets, an ally both of governments, in the context of their regulatory activity, and investors, in their quest for information and profit.

The 2007-2008 financial crisis[1] and the sovereign debt crisis which has plagued Europe since the start of 2010[2] brought to light the true role of rating agencies on the markets. After having been criticised for not having foreseen the subprime crisis, the agencies were pilloried again by politicians for having accelerated the national debt crisis in Europe.

The European Union (EU) was quick to take action: scarcely a year after the outbreak of the 2008 financial crisis, the EU adopted, in September 2009, a first regulation on rating agencies.[3] Far from being an end point, however, this regulation, which will be discussed below, was only the first step in the development of a regulatory structure for rating agencies. Indeed, the technical nature and scope of the regulation indicate a clear will on the part of the EU to provide a regulatory framework for credit rating agencies, to which it deems insufficient attention was paid in the past.

The EU plans to expand its arsenal with two new pieces of legislation, which had not been adopted at the time of writing.[4] A future regulation[5] and directive,[6] proposals for which were published by the Commission in November 2011, aim to more specifically regulate rating activity and to progressively eliminate all references to ratings in Community legislation. The flip side of this legislative onslaught, in the Commission's opinion, is that the new rules will allow rating agencies to recover the legitimacy they allegedly lost during the recent crises.

The legal framework applying to credit rating agencies is of major interest for everyone active in the financial sector as it appears clearer every day that the aim of the European Commission is not to make of credit rating agencies legislation an exception. Rather, directives and regulations adopted to regulate the rating activity are likely to become models for other regulations in the field of the regulation of other financial institutions, such as credit establishments, insurers, UCITS, and so forth. Credit rating agencies are at present acting as a legislative guinea pig for the Commission. Knowing the legal framework applying to credit rating agencies is the best way to discover the trends of the future European financial legislation.

This article is structured as follows. First, the rating agencies and the results of their activity, namely, credit ratings, are presented (Section 2). Before analysing the proposals for the directive and regulation published by the EU at the end of 2011 (Section 4), the currently applicable legislative framework is set out (Section 3). Finally, the article ends with several critical reflections on the Community legislation on rating agencies (Section 5).

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1. Gaillard 2010; Piquemal 2009.
2. De Santis 2012; Kiff *et al.* 2012.
3. Regulation (EC) No. 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (hereinafter "Regulation No. 1060/2009"), [2009] OJ L 302.
4. This article has been updated until 30 September 2012.
5. Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No. 1060/2009 on credit rating agencies, COM(2011), 747 final (hereinafter the "Proposal for a Regulation").
6. 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, COM(2011), 746 final (hereinafter the "Proposal for a Directive").

2. Ratings and Rating Agencies

2.1 Ratings

A credit rating (or note) is an independent opinion of a rating agency on the ability of a public or private issuer to reimburse its debt.[7] The rating allows investors to assess the issuer's risk of default, that is, the risk of non-reimbursement. The agencies use three letters to present their ratings, sometimes accompanied by a plus or minus sign.[8] The rating allows investors to immediately identify the degree of risk, with the letters representing a scale of potential default, from AAA (the famous triple-A or highest rating) to D (no reimbursement possible, the issuer is bankrupt). While all rating agencies use the same letters, they differentiate themselves by using different combinations of upper- and lower-case letters, different scales and above all different methodologies to determine their ratings.[9] Moreover, the agencies have adopted different rating methods depending on the debt security they are rating (bonds, sovereign debt, etc.). However, all agencies distinguish between investment-grade and speculative-grade debt, the latter being more commonly referred to as junk bonds. Issuers whose debt falls into the former category instil confidence in the market, which means they are offered better interest rates and thus can obtain financing more easily.[10] Companies whose debt falls into the second category will encounter greater difficulties, as many contracts contain rating trigger clauses.[11] If the debt's rating falls below investment grade, such a clause provides for accelerated reimbursement, at the very least, and possibly additional interest, penalties, and so forth. Such clauses are considered to be one of the factors that exacerbated the crisis, by aggravating the liquidity problems of corporate borrowers.

Furthermore, as some important institutional investors (such as pension funds) are prohibited from purchasing speculative-grade debt, it is crucial for every issuer of bonds to be well rated by the agencies.

2.2 The Rating Agencies

The first credit ratings were issued for American railroad securities in *Moody's Analyses of Railroad Investments* back in 1909.[12] Slightly over a century later, there are essentially only three big rating agencies: Moody's (US), S&P (US), and Fitch (US, but whose majority shareholder is the French group Fimalac). As a result of various mergers, these three players have controlled the credit ratings market since the 1940s, having gradually taken over their competitors.[13] In 2008, it was estimated that the Big Three controlled 94% of the global market for credit ratings.[14] The debt rated by American agencies has been estimated at US$30 billion, possibly even trillion.[15] Indeed, issues on the European securitization market in 2006 alone reached €450 billion.[16] In certain years, the rating of structured products alone has accounted for half the agencies' turnover.[17]

During the first decades of their existence, rating agencies turned a profit by selling their analyses directly to investors. Thus, their work initially closely resembled that of financial analysts, who advise their clients on the purchase of shares and other corporate securities, with the main difference being that rating agencies issue opinions on debt securities. Subsequently, in the mid 1970s, the agencies changed their *modus operandi* and adopted the so-called issuer-pays model,[18] about which much has been written.[19] Under this model, it is no longer the investor in search of information that pays the agency to know its opinion on the likelihood of reimbursement of a given debt but rather the issuer which compensates the agency to rate a debt security it has issued or will issue. Two reasons are most frequently cited to explain this paradigm shift. On the one hand, by changing the model, the agencies solved the free-rider problem, namely, persons who did not pay for their work were able to benefit from it due to the spread of photocopies. On the other hand, and more fundamentally, this change of model responded to a need for companies to have their debt rated in order to be able to obtain non-bank financing. A poorly rated or unrated company will find it very difficult to obtain market financing at fair rates.[20] Indeed, borrowing rates are

7. See the definition of rating in Regulation No. 1060/2009, Art. 3(1)(a): "an opinion regarding the creditworthiness of an entity, a debt or financial obligation, debt security, preferred share or other financial instrument, or of an issuer of such a debt or financial obligation, debt security, preferred share or other financial instrument, issued using an established and defined ranking system of rating categories". In the literature, see ECB 2004, p. 7; Blaurock 2007; Charles 2010; Husisian 1989-1990; Lynch 2009; Partnoy 2006; Wymeersch & Kruithof 2006.
8. Not to mention the indicators of *watch* and *outlooks*. ECB 2004, p. 7; Kerwer 2002.
9. S&P 2006, 2010. See also Le Figaro 2010a; Blaurock 2007, p. 3; Sack & Juris 2007.
10. Association for Financial Professionals (AFP) 2002; Blaurock 2007, p. 7; Bruyninckx 2007-2008, p. 76; Conac 2006, p. 69; Husisian 1989-1990, p. 418; Listokin & Taibleson 2010.
11. AFP 2010, p. 6; ECB 2004, pp. 12-15; Blaurock 2007.; United States Senate Committee on Governmental Affairs 2002, p. 3; Lynch 2009, p. 20.
12. AFP 2010, p. 19; Gaillard 2010, p. 7; Partnoy 2006, p. 62; Rousseau 2006.
13. Gaillard 2010, p. 10.
14. Commission Staff Working Document, Impact Assessment, "Accompanying document to the Proposal for a Regulation of the European Parliament and of the Council amending Regulation No. 1060/2009 on credit rating agencies", 2 June 2010, SEC(2010) 678, 6; Blaurock 2007, p. 5; Gaillard 2010, p. 11; Piquemal 2009, p. 144; Wymeersch & Marc Kruithof 2006, footnote 18.
15. Listokin & Taibleson 2010, p. 92.
16. AMF 2007, p. 7.
17. Du Marais & Froute 2008.
18. Please note the smaller rating agency Egan-Jones works on an investor-pays model. Available at: <www.egan-jones.com>.
19. See Commission Staff Working Document, Impact Assessment, "Accompanying Document to the Proposal for a Regulation of the European Parliament and the Council on Credit Rating Agencies", p.15; Gaillard 2010, p. 12; Lynch 2009, pp. 20-22; Partnoy 2006, p. 69; Rousseau 2006, p. 625; Rousseau 2009; Sack & Juris 2007; United States Securities and Exchange Commission SEC(2008), pp. 23-27, 31-32. See the reactions of the rating agencies: Moody's 2011, pp. 17-21; S&P 2010, p. 9; *USD Today* 2010, expressing the position of Deven Sharma, president of Standard & Poor's.
20. Gaillard 2010, p. 40.

based on a company's credibility, its assessed ability to reimburse its debts in full and on time. This movement continued with the growth in the number of structured products and the upstream involvement of agencies in the rating process, during the structuring of the products themselves. While traditional debt securities (such as bonds and government bonds) were – and are – not rated by agencies until after they are created, securitized products are, as the saying goes, "structured to be rated". [21] The conflicts of interest this practice can generate are obvious.[22]

A second factor contributed to turning rating agencies into key players on the financial markets, namely, their assumption of the role of regulatory arbiter.[23] This phenomenon is particularly evident in the case of the Big Three. Indeed, it is often the international reputation of these agencies which is sought, as expressly mentioned in the legislation.[24] Once again, this movement originated in the United States. Following the 1929 stock market crash, rules were adopted preventing American banks from buying speculative or defaulted securities.[25] Numerous other countries adopted similar measures, adapted to reflect market developments, as evidenced by the introduction of a ban on the acquisition by certain institutional investors, in particular American pension funds, of speculative-grade debt securities.[26] The apogee of this movement was the consecration of the role of rating agencies in determining the capital requirements for banks upon the conclusion of Basel II, an accord which is binding on most countries active on the financial markets.[27]

This brief presentation of rating agencies clarifies the key role[28] they have played for quite some time on the markets, safe from any regulation.

3. Regulation No. 1060/2009: The Introduction of Oversight and the First Provisions on Rating Activity

Before the entry into force of Regulation No. 1060/2009,[29] there was no legislation regulating the activity of rating agencies in Europe. There was only soft law,

21. As Mr Prada, then president of the French Financial Markets Authority, noted "la notation n'est plus le constat ex-post d'une situation donnée mais l'objectif fixé ex-ante d'une entité à créer. En outre et compte tenu de la complexité des produits, un grand nombre d'investisseurs se sont reposés largement sur l'analyse réalisée par les agences au-delà, sans doute, de ce qui aurait été raisonnable (…)", cited in Piquemal 2009, pp. 140-141. Free translation: "a rating is no longer an observation of a given situation after the fact but rather a pre-determined objective of an entity to be created. Moreover and given the complexity of the rated products, many investors rely heavily on the analyses made by the agencies, beyond, no doubt, what would be reasonable (…)".
22. Blaurock 2007, pp. 30-32; Charles 2010, pp. 427-434; Du Marais & Froute 2008, p. 4; Listokin & Taibleson 2010, p. 99; Partnoy 2006, pp. 68-73; Rousseau 2009, pp. 634-635.
23. For a presentation of this role in European law, see the Commission's summary, "Public Consultation on Credit Rating Agencies (Consultation Paper)", 5 November 2010, pp. 29-32. For Belgium, see Art. 1 of the Royal Decree amending the rules on the investment of funds of the National Pensions Office of 12 August 1993; Arts. 6, 22 and 56 in particular of the Royal Decree on undertakings for investment in debt securities of 29 November 1993; point II. 11 of the Circular on the 2005 budget of municipalities in the Walloon Region, with the exception of those in the German-speaking Community, of 7 October 2004; Arts. 23 §2 of the Royal Decree on certain undertakings for collective public investment of 4 March 2005; Chapter 6 of the Decree of the Banking, Finance and Insurance Commission on the regulation of the equity of credit institutions and investment companies of 17 October 2006; Art. 63, last sentence, of the Royal Decree on rules and conditions to transpose the directive on markets in financial instruments of 3 June 200; AFP 2002, p. 19; European Commission, "Public consultation on Credit Rating Agencies", p. 5; IOSCO 2004, p. 2; Blaurock 2007, pp. 8-9; Lynch 2009, pp. 18-19; Partnoy 2006, pp. 81-83; Piquemal 2009, pp. 154-160; Pinto 2008; Wymeersch & Marc Kruithof 2006, pp. 7-8.
24. Notably for Belgium, see Annex II to the technical Regulation on the management of and access to the electricity distribution network in the Brussels-Capital Region, adopted pursuant to Art. 11 of the Ordinance of 19 July 2001 on the organisation of the electricity market in the Brussels-Capital Region, which provides that, in order to have access to the Brussels network, it is necessary to have "an […] official rating issued by a recognised rating agency which corresponds to at least A3 according to the definition of *Standard & Poor's, Moody's or Fitch* as defined by Moody's. This minimum rating must be maintained for the entire duration of the contract concluded with the manager of the distribution network" (emphasis added); Art. 14 §2 of the Act on the reserves established for the dismantlement of nuclear power plants and the management of fissile materials irradiated at said plants of 11 April 2003, which provides that the general lien on movables will be lost in the absence of a guarantee by the "parent company of the nuclear operator or [by] a credit institution […], provided the guarantor in question possesses a credit rating issued by *an internationally known rating agency* corresponding to a maximum loan-to-value ratio of 75% (…)" (emphasis added). See also Directive 2006/48/EC, Art. 75 ("Minimum level of own funds") and Annex VII, Part 4, Section 2.1 on risk quantification.
25. Gaillard 2010, p. 103.
26. Wymeersch & Kruithof 2006, pp. 8-9 and 13, where the authors mention the case of the National Pensions Office.
27. The Member States of the Basel Committee on Banking Supervision are, as of 30 September 2012: South Africa, Germany, Saudi Arabia, Argentina, Australia, Belgium, Brazil, Canada, China, Korea, Spain, the United States, France, Hong Kong, India, Indonesia, Italy, Japan, Luxembourg, Mexico, The Netherlands, the United Kingdom, Russia, Singapore, Sweden, Switzerland and Turkey. Available at: <www.bis.org/about/factbcbs.htm>.
28. Partnoy 2006, p. 61; Praet, "Il y a urgence pour une action européenne forte", *Revue bancaire et financière* 2009/2-3, p. 92; Rousseau, "Enhancing the Accountability of Credit Rating Agencies", p. 620; Wymeersch & Kruithof 2006, p. 3.
29. Regulation No. 1060/2009.

namely, a code of conduct[30] adopted in 2004 by the International Organization of Securities Commissions (IOSCO). This code of conduct serves as the basis for the regulation of rating agencies not only in Europe but also worldwide.

In the Regulation, the EU opted for an intermediate approach, midway between no government regulation and the establishment of heavy prudential norms.[31] In reality, it appears that the EU's will to act quickly pushed it to adopt, at least initially, a relatively light regulatory framework. Indeed, the EU had to react just after the financial crisis broke and wished to send a strong signal of its intention to regulate the markets. The adoption of Regulation No. 1060/2009 was only the first step in the regulation of rating agencies by the EU.

Adopted on 16 September 2009, the Regulation has been in full force since 7 June 2011.[32] The main purpose of the Regulation was to establish a registration procedure for rating agencies. Of the Regulation's 41 articles, only 8 touch on the issuance of ratings, strictly speaking. However, one should not be misled by this perceived imbalance. The Community legislature did not scrimp when it came time to regulate rating activity, but the rules are less visible since, with respect to rating agencies, it used an increasingly common technique, namely, the delegation of its legislative powers to the Commission, on the one hand, and a sub-body of the Commission, namely, the European Securities and Markets Authority (hereinafter "ESMA"), on the other.[33] As a result of this increasingly popular technique, the agencies' obligations in terms of ratings and the methodologies used to determine them are not found in the Regulation itself but rather in its annexes, which the Commission has the power to modify "in order to take into account developments on the financial markets",[34] and in the delegated regulations prepared by ESMA and subsequently approved by the Commission. In order to understand the obligations of rating agencies, it is thus necessary to take into account not only the Regulation itself but also the Commission delegated regulations.[35]

3.1 The Scope of Regulation No. 1060/2009

The Regulation applies to publicly disclosed credit ratings issued by credit rating agencies registered in the Community. Thus, the Regulation does not cover[36] personalised credit ratings for private use (which are considered advice and thus fall within the scope of MiFID), credit scores,[37] credit ratings produced by external credit assessment institutions (ECAI), or credit ratings produced by a central bank, under certain conditions.[38]

The Regulation applies only to ratings issued by agencies registered in the Community. Although there is no obligation for credit rating agencies to register with a regulatory authority in the EU, the Regulation does oblige, on the other hand, any institution that wishes to use a credit rating to rely only on those issued by registered agencies. At the risk of losing their clients, rating agencies thus had no choice but to submit to the new regulatory framework, especially since the Community has established a system to oversee credit notes from non-Member States (endorsement and certification procedures).

3.2 Three Ways to Register

The EU has put in place a system of registration for rating agencies based on their nationality. Agencies located in any of the 27 Member States of the EU must register, in the strict sense, while foreign agencies that have no

30. The code is available (in English only) on IOSCO's website. Available at: <www.osco.org/library/pubdocs/pdf/IOSCOPD271.pdf>.
31. Colmant, 2011, p. 104.
32. Art. 41 Regulation No. 1060/2009.
33. Until 1 July 2011, the registration procedure was delegated to the national regulatory authorities designated by the member states as competent for this matter, see Arts. 15 and 22 Regulation No. 1060/2009.
34. Art. 37 Regulation No. 1060/2009.
35. On 30 May 2012, four Commission Delegated Regulations establishing regulatory technical standards for credit rating agencies have been published in the Official Journal of the European Union. See Commission Delegated Regulation (EU) No. 446/2012 of 21 March 2012 supplementing Regulation (EC) No. 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards on the content and format of ratings data periodic reporting to be submitted to the European Securities and Markets Authority by credit rating agencies; Commission Delegated Regulation (EU) No. 447/2012 of 21 March 2012 supplementing Regulation (EC) No. 1060/2009 of the European Parliament and of the Council on credit rating agencies by laying down regulatory technical standards for the assessment of compliance of credit rating methodologies; Commission Delegated Regulation (EU) No. 448/2012 of 21 March 2012 supplementing Regulation (EC) No. 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards for the presentation of the information that credit rating agencies shall make available in a central repository established by the European Securities and Markets Authority; Commission Delegated Regulation (EU) No. 449/2012 of 21 March 2012 supplementing Regulation (EC) No. 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards on information for registration and certification of credit rating agencies.
36. Art. 2 Regulation No. 1060/2009.
37. Credit scores are primarily used internally by credit institutions to assess the risk when granting a consumer loan (Barret Barnay 2002, footnote 21) or to assess the risk of their bond portfolios (Van Gestel *et al.* 2003).
38. At present, only the Bank of France has been duly exempted by the Commission for its commercial rating activities: Decision of the Commission of 18 June 2010 exempting the Bank of France from the application of Regulation (EC) No. 1060/2009 of the European Parliament and of the Council on credit rating agencies [C(2010) 3853]. Available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:154:0029:0030:FR:PDF>.

presence on European soil are subject to the endorsement or certification procedure.

3.2.1 Registration

For agencies based in the EU, in order to be able to continue or to start rating activities in Europe, the only available procedure is registration with ESMA. The information to be provided in the application for registration is set out in Annex II to the Regulation,[39] according to which the agency must describe its overall organisational structure, ownership structure, rating methods, international policies, compensation arrangements, etc. Specific rules have moreover been adopted for groups of rating agencies and small agencies (fewer than 50 employees).[40]

Nevertheless, despite the adoption of a first circular by CESR (now ESMA),[41] the rating agencies have encountered numerous difficulties in completing their files, as evidenced by a report released by ESMA in 2012.[42] Indeed, Fitch, Moody's and S&P alone have submitted close to 30,000 pages of documents to ESMA.

On 21 March 2012, Commission Delegated Regulation No. 449/2012,[43] prepared by ESMA, was adopted, specifying with greater precision the information to be provided by the agencies for the purposes of registration or certification. The late adoption of this text is unfortunate. At the time of writing, 37 rating agencies had registered with ESMA[44] (including 6 branches of Moody's, 7 branches of Fitch and 3 branches of S&P). Undoubtedly, the delegated regulation merely formalises solutions already put into practice by ESMA when the first agencies submitted their files. It indeed simply lists the information to be provided, along with twelve annexes which the agencies must scrupulously complete.

Aside from the registration procedure, there are two other procedures, namely, endorsement and certification, to allow the importation and above all the use of credit notes issued outside the 27 EU Member States.

3.3 The Establishment of Supervision of Rating Methods

The second subject covered by Regulation No. 1060/2009 is the issuance of credit ratings. The obligations of the agencies with respect to the publication of their ratings fall under three main themes: the quest for quality ratings, the fight against conflicts of interest and the introduction of rules to ensure transparency.[45] To understand the scope of the applicable rules, reference can be made, for the most part, to the technical standards issued by ESMA and formalized in the May 2012 Commission delegated regulations.[46]

3.3.1 The Quest for Quality Ratings

Quality ratings require quality methodologies, described by the Regulation as "rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing".[47] The importance which the Community legislature and ESMA attach to rating methodologies can be attributed to the finding that, for years, the agencies apparently used out-of-date or inappropriate models.[48] To solve this problem, ESMA was entrusted with developing standards to allow the assess-

39. See Annex II to Regulation No. 1060/2009.
40. ESMA, "Draft RTS on the content and format of ratings data periodic reporting to be requested from credit ratings agencies for the purpose of on-going supervision by ESMA (Final report)", 22 December 2011, ESMA/2011/464, p. 6, 15-16; ESMA, "Draft RTS on the assessment of compliance of credit rating methodologies with CRA Regulation (Final report)", 22 December 2011, ESMA/2011/462, pp. 8-9, 17; Commission Delegated Regulation (EU) No. 272/2012 of 7 February 2012 supplementing Regulation (EC) No. 1060/2009 of the European Parliament and of the Council with regard to fees charged by the European Securities and Markets Authority to credit rating agencies, OJ L 90/6 of 28 March 2012, Arts. 5(3)-(5).
41. CESR, "Guidance on Registration Process, Functioning of Colleges, Mediation Protocol, Information set out in Annex II, Information set for the application for Certification and for the assessment of CRAs systemic importance", 4 June 2010, CESR/10-347. See also the report accompanying the proposal for a delegated regulation: ESMA, "Regulatory technical standards on the information for registration and certification of credit rating agencies", 22 December 2011, ESMA/2011/563.
42. ESMA, "Annual report on the application Regulation on credit rating agencies as provided by Arts. 21(5) and 39a of the Regulation (EU) No. 1060/2009 as amended by Regulation No. 1095/2010", 12 January 2012, Doc. ESMA/2012/3, pp. 5-6.
43. Commission Delegated Regulation (EU) No. 449/2012 of 21 March 2012 supplementing Regulation (EC) No. 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards on information for registration and certification of credit rating agencies, OJ L 140, 30 May 2012.
44. This list was last updated on 3 June 2013, see ESMA's website. Available at: <www.esma.europa.eu/page/List-registered-and-certified-CRAs>. By way of comparison, the US Securities and Exchange Commission's list of recognized rating agencies, the NRSRO, includes only a dozen agencies. Available at: <www.sec.gov/answers/nrsro.htm>.
45. See Title II of the Regulation, entitled simply "Issuing of Credit Ratings". This part include eight articles, only five of which contain rules relating specifically to credit ratings, namely Arts. 6 ("Independence and avoidance of conflicts of interest"), 7 ("Rating analysts, employees and other persons involved in the issuing of credit ratings"), 8 ("Methodologies, models and key rating assumptions"), 10 ("Disclosure and presentation of credit ratings") and 11-12 ("General and periodic disclosures" and "Transparency report").
46. Commission Delegated Regulation (EU) No. 446/2012 of 21 March 2012 supplementing Regulation (EC) No. 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards on the content and form of ratings data periodic reporting to be submitted to the European Securities and Markets Authority by credit ratings agencies, adopted 21 March 2012, OJ L 140, 30 May 2012; Commission Delegated Regulation (EU) No. 447/2012 of 21 March 2012 supplementing Regulation (EC) No. 1060/2009 of the European Parliament and of the Council on credit rating agencies by laying down regulatory technical standards for the assessment of compliance of credit rating methodologies, adopted on 21 March 2012, OJ L 140, 30 May 2012; Commission Delegated Regulation (EU) No. 448/2012 of 21 March 2012 supplementing Regulation (EC) No. 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards for the presentation of the information that credit rating agencies shall make available in a central repository established by the European Securities and Markets Authority, adopted 21 March 2012, OJ L 140, 30 May 2012; Commission Delegated Regulation (EU) No. 449/2012 of 21 March 2012 supplementing Regulation (EC) No. 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards on information for registration and certification of credit rating agencies, adopted 21 March 2012, OJ L 140, 30 May 2012.
47. Art. 8(3) Regulation No. 1060/2009.
48. Bussani 2010, Art. 1, p. 1; Charles 2010, p. 406; Du Marais & Froute 2008, p. 1; Friedman 2009; Kerwer 2002, p. 40; Praet 2009, p. 92; Utzig 2008.

ment of compliance by the agencies with the requirement of suitable, up-to-date methodologies.[49]

The obligations incumbent on the agencies include a duty to ensure that their methodologies are continuously adapted and updated,[50] to clearly indicate the name and job title of the lead analyst as well as the person primarily responsible for approving the credit rating prior to publication, to present all material sources used to determine the rating, the methodology used as well as the version thereof, to present systematically each rating category (sovereign debt, company debt, structured products, etc.), to mention the date of the first rating as well as that of any updates, and finally to indicate very clearly if the rated debt is a structured product. In the latter case, the rating agency must provide additional information and indicate the level of assessment it has performed. Finally, for structured finance instruments, rating agencies must, in the words of the Regulation, issue "guidance [that is] clear and easily comprehensible". The Community legislature's will to render the rating process as transparent as possible for the general public is obvious, but the practical implementation leaves something to be desired.

Moreover, the agency is obliged to inform the entity whose debt is being rated, at least 12 hours before publication, of the rating it intends to grant and the principal grounds on which the rating is based in order to give the entity an opportunity to point out "factual errors".[51] This provision should not be given undue weight. In the past, credit rating agencies already provided such information to the entities whose debt they were rating, usually with far more than twelve hours' notice. Moreover, the agencies are not obliged to provide detailed information about their ratings, only to present the principal grounds. Will this comprehensive body of legislation help to enhance the quality of the ratings? Or will help to find out errors ratings agencies would have made? We are not convinced that expanding exponentially information rating agencies have to made public will result in an enhanced transparency. The only avoidable risk is that of gross negligence on the part of the agency, which remains a case study.

3.3.2 The Fight Against Conflicts of Interest

Conflicts of interest on the part of the ratings agencies have been pointed out on numerous occasions. These conflicts primarily arose due to the issuer pays model, as described above, but were also attributable to the fact that the market on which rating agencies are active is very fragmented, and it is quite common for issuers and agencies to establish long-term relationships.

A number of measures have been adopted to try to limit conflicts of interest on the part of rating agencies. The first type of measures directly targets the agencies' structure. The Regulation requires rating agencies to meet certain "organisational requirements".[52] Thus, credit rating agencies must have an administrative or supervisory board, at least one-third of whose members (but no less than two) are not involved in credit rating activities. These independent members are assigned specific tasks relating to monitoring the development of credit rating policy, the effectiveness of measures introduced to prevent conflicts of interest, etc. In addition to governing the very composition of the management organs of credit rating agencies, the Regulation also requires the agencies to establish and disclose policies and procedures intended to ensure the independence of their rating activity, which implies a clear distinction between these activities and other (accessory) activities. The latter can never jeopardize the integrity of the rating process.[53] Moreover, it is henceforth clearly forbidden for agencies to advise an entity they are rating on the structure of its debt or on its activities.[54]

The second type of measures pertains to rating analysts. Their remuneration and activity are henceforth regulated by the EU. Indeed, it was noted that analysts sometimes negotiated, to a certain extent, their remuneration directly with the client and that this remuneration could be linked to the revenue generated by the product they were rating. The EU thus decided to intervene in order to prohibit the direct negotiation of salaries between analysts and issuers, on the one hand, and to ban any link between remuneration and turnover, either of the agency for which the analyst works or of the issuer, on the other. Moreover, to prevent the development of personal relations between issuers and analysts, the Commission has developed an analyst rotation system.

3.3.3 The Introduction of Transparency Rules

In addition to rules on the quality of ratings and the internal organization of credit rating agencies, the EU has introduced significant transparency obligations for rating agencies.[55]

49. CERVM, "Guidance on common standards for assessment of compliance of credit rating methodologies with the requirements set out in Art. 8.3", 30 August 2010, CESR/10-945; ESMA, "Regulatory technical standards on the assessment of compliance of credit rating methodologies with the requirements set out in Art. 8(3) of Regulation (EC) No. 1060/2009 (Consultation Paper)", September 2011, ESMA/2011/303; ESMA, "Draft RTS on the assessment of compliance of credit rating methodologies with CRA Regulation (Final Report)", 22 December 2011, ESMA/2011/462.
50. Note that in the politically agreed draft regulation, it is also foreseen that where appropriate, rating methodologies should take into account financial risks deriving from environmental hazards (Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No. 1060/2009 on credit rating agencies – political agreement, Preamble, para. 19).
51. Annex I, Section D, Part I.3 ("Rules on the presentation of credit ratings"), Regulation No. 1060/2009.
52. Annex I, Section A, Regulation No. 1060/2009.
53. See Art. 22 of ESMA's proposal for a delegated regulation: ESMA, "Regulatory technical standards on the information for registration and certification of credit rating agencies", 22 December 2011, ESMA/2011/463, p. 29.
54. Annex I, Section B, point 4 ("Operational requirements") Regulation No. 1060/2009.
55. The information to be provided to ESMA is mainly described in Annex I, Section E of Regulation No. 1060/2009 and in the Commission delegated regulations.

In general, rating agencies must ensure that their registration with ESMA is public at all times, release a list of actual and potential conflicts of interest, a list of ancillary services, their policy concerning the publication of credit ratings, compensation arrangements, the applicable code of conduct, if any, a description of the methodologies they apply and the key assumptions on which they rely, and any modifications to this information. Periodically, the agencies must inform the market of historical default rates of their rating categories and indicate their most important clients. Moreover, each year, the agency must prepare a transparency report[56] containing the information defined in Regulation No. 1060/2009.[57] Financial institutions will already be familiar with this requirement.[58] Rating agencies must include in this report information about their organizational structure and shareholders, describe their internal control mechanisms, present the allocation of their staff to rating and other activities, describe their record-keeping policy[59] and their rating analyst rotation policy, indicate the outcome of their annual internal review and provide a corporate governance statement, and finally divide their revenue into fees from credit rating activities and other activities. The first versions of these reports have already been published and reveal a great deal of disparity. Looking only at those prepared by the Big Three, namely Fitch,[60] Moody's[61] and S&P,[62] it can be noted that Fitch's report is over one hundred pages long while Moody's and S&P's are only thirty pages. Furthermore, as there are no specific rules governing the presentation of financial information by the agencies in their transparency report, one cannot help but notice that these reports are not the most readable. Thus, the agencies took pains to camouflage their total revenue, each providing a breakdown per group entity. Each group has entities both within and outside the eurozone, but none bothered to present their total revenue in a single currency. Anyone who would like to get a clear idea of the finances of rating agencies in Europe is advised to grab a calculator! The information has certainly been disclosed, but the objective of transparency is not fully achieved.

Violation of the rules presented above did not initially result in the imposition of particular sanctions in the EU. However, a response was not a long time in the making: Regulation No. 513/2011[63] was adopted in May 2011 to introduce a repressive component to Regulation No. 1060/2009. This article does not describe the various sanctions in detail. Suffice it to say that the potential sanctions are particularly dissuasive, with non-observance of the rules on conflicts of interest and organizational and operational requirements subject to the heaviest sanctions (between €500,000 and €750,000 per violation). In addition to the ability to impose sanctions and fines, ESMA has an even more redoubtable weapon, namely, the power to withdraw an agency's registration, temporarily or permanently, and to suspend use of a breaching agency's credit ratings until the breach is remedied.[64]

4. The Future of the Regulation of Credit Rating Agencies

While it is not possible in this article to provide a detailed presentation or in-depth analysis of the new rules proposed by the Commission,[65] the main ideas are presented below, which in short call for greater supervision of credit rating agencies, the establishment of civil liability rules, and a fundamental questioning of the position and role of rating agencies in the EU.

4.1 Greater Supervision of Rating Agencies

Supervision of credit rating agencies, established through the introduction of a registration procedure and the rules presented above on the issuing of ratings, will be further strengthened. Thus, the scope of application of the Regulation will be broadened, participation in the capital of agencies circumscribed, and rotation, already applicable for analysts, extended to the agencies themselves. For some of the proposed new measures, in particular those dealing with the disclosure of ratings, the Community legislature obviously drew inspiration from the eurozone crisis. This is clearly the case with the proposed rules on sovereign credit ratings, which formed the object of *ex ante* mobilization by the rating agen-

56. Art. 12 Regulation No. 1060/2009.
57. *Ibid.*, Annex I, Section E ("Disclosures"), Part III ("Transparency report").
58. See *e.g.*, Directive 2004/109/EC of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (the "Transparency Directive"); Caprasse 2010; Duplat 2009; Feron & Berlingin 2008; Lopez Martinez & Snoy 2009; J. Malherbe *et al.* 2011; Nejman 2007.
59. The Regulation requires rating agencies to keep records of their ratings for five years; see Annex I, Section B, Art. 8.
60. Fitch Ratings 2012.
61. Moody's 2010.
62. Standard & Poor's 2011a.
63. Regulation (EU) No. 513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation (EC) No. 1060/2009 on credit rating agencies, OJ L 145, 30-56.
64. Art. 24 Regulation No. 1060/2009.
65. Note that on 4 December 2012, the European Council was informed that a political agreement was reached with the European Parliament on proposals to amend the EU's rules on credit rating agencies (Council of the European Union, Press Release, Meeting of 4 December 2012, Doc. 17131/1/12 Rev 1). Those amendments will be further discussed at one of the first sessions of the EU's Parliament in 2013, on 15 January (European Parliament, Draft agenda, 14-17 January 2013, Strasbourg, doc. 500.369/POJ). See also the notes dated 3 December 2012 from the General Secretariat of the Council to the Permanent Representatives Committee – Part II (Doc. EF 285 ECOFIN 1009 CODC 2883) and to the Delegations (Doc. EF 280 ECOFIN 989 CODEC 2782 "Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No. 1060/2009 on credit rating agencies – political agreement").

cies,[66] as the Commission tried to create a two-tier system, favouring the states.

4.1.1 Oversight of the External (Shareholder) Structure of Rating Agencies

As described above, rules were initially introduced for the purpose of ensuring a minimum number of independent directors on the board of directors of credit rating agencies. To strengthen this independence, the Community legislature now proposes prohibiting anyone who holds at least 5% of the capital of a rating agency from holding more than 5% of the capital of another agency (unless the two agencies are part of the same group). This prohibition is intended to ensure the independence of rating agencies from one another, as investments for strictly economic purposes and those made through undertakings for collective investment should not be affected.[67]

4.1.2 Extension of the Rotation Rules

The Commission's new proposal changes the scale of rotation. Initially, only analysts were concerned; the plan is now to apply the rotation rules to the agencies themselves. Primarily under the proposed system agencies would not have been allowed to rate a particular issuer for more than four years.[68] This period was shortened to one year if, during the first year, the agency rated more than ten debt instruments of the issuer. Moreover, a four-year waiting period between rotations was proposed. This new system entailed so many constraints that, in reality, it was highly unlikely to be applied. Indeed, as indicated above, at present, 32 agencies have registered with ESMA, 16 of which belong to only 3 groups (Fitch, Moody's and S&P). As rotation could not take place between companies in the same group, files would have to be transmitted to competitors, which would have to be able to handle them. For structured products in particular, only agencies that had achieved a certain critical mass are able to do so. Further, the issuer's freedom would have been impinged, as it would have to choose from amongst a limited number of agencies to rate its debt. These issues all called into question the merits of the proposed rotation system.

In its latest proposals of amendments, the European Parliament had proposed to partially remove from the draft regulation the provisions describing the rotation system. Early December 2012, a political agreement was subsequently reached thereupon.[69] For now on and at least as long as the credit rating market has not itself extended, the scope of the rotation mechanism will be limited to particular financial products such as re-securitizations. These products have been chosen for the introduction of the rotation mechanism because the credit rating agencies active on this market are currently very limited. Both the European Parliament and the Commission are of opinion that introducing a rotation system for re-securitizations products could be a driver for creating more dynamics and bring more diversity in this market.

4.1.3 New Rules Applicable to All Types of Ratings

Two new rules will apply across the board to all types of credit ratings. The first requires agencies to disclose detailed information about all entities and debt instruments they rate for the first time. This obligation already existed for the rating of structured products. Second, as a result of the recent eurozone crisis, the Commission has provided that rating agencies can only disclose their ratings at certain times. Indeed, the terrible scenes caused by the announcement of credit rating downgrades several minutes before the opening of the markets are still fresh in everyone's mind, and the Community legislature clearly does not want such scenes to recur in the future. Consequently, it wishes to require rating agencies to give not only at least a full working day notice of a rating (or rating outlook) but to issue their ratings, along with a mention of the principal grounds on which they are based, during the issuer's business hours and at least one full working day in advance. The Commission wants issuers to be able to effectively respond to the rating and make verifications, if necessary, which they cannot do if the agency discloses its rating during the night or at the week-end, when most employees of issuers are not around.

4.1.4 New Rules on the Rating of Structured Products

The rating of structured financial instruments attracted the attention of the Community legislature back in 2008, immediately following the financial crisis. In addition to the rules already contained in the Regulation, the November 2011 proposal requires rating agencies to continuously disclose more and more information about the underlying assets. The idea of the Commission is that investors' possibilities to make an himself an assessment of the credit worthiness of structured finance instruments would be improved if investors were provided with sufficient information on these instruments. Due to their complexity, this position is, however, very theoretical.

A new rule will be imposed not on the rating agencies themselves but on issuers instead. The latter can no longer have their products rated by a single agency but rather must obtain two ratings, from two independent agencies. Moreover, when issuers intend to or are compelled to use multiple ratings, they will have to consider the possibility to mandate at least one credit rating agency which does not have more than 10% of the total market share and which can be evaluated by the issuer as capable for rating the relevant issuance or entity, provided that there is a credit rating agency available for rating the specific issuance or entity. In the case where the issuer decides not to mandate at least one credit rating agency which does not have more than 10% of the total market share, this shall be documented. Given the cost a

66. Fitch Ratings 2011; Moody's 2011; Standard & Poor's 2011b.
67. Proposal for a Regulation, p. 21.
68. The initial proposal of the Commission was that the length of the period should not exceed three years.
69. See the note dated 3 December 2012 from the General Secretariat of the Council to the Delegations (Doc. EF 279 ECOFIN 988 CODEC 2781).

rating can represent for issuers and the restrictions arising from the agency rotation system, if implemented, this new obligation in reality bears the hallmarks of an attack on structured instruments rather than on the agencies themselves.

4.1.5 Rules on Sovereign Credit Ratings

The Community legislature has long considered sovereign credit ratings to be different from the ratings of corporate debt and structured financial instruments[70] and that they should therefore be subject to special rules.

Firstly, sovereign ratings will have to be revised systematically and at least twice per year, not annually as the Regulation currently provides. The idea underlying this new rule is that if adjustments are made to sovereign ratings more frequently, the market can anticipate them and will be less surprised and thus less volatile. Moreover, in order to reduce the risk of volatility, credit rating agencies will be required to only publish these ratings after the close of business of the trading venues established in the Union and at least 1 hour before their opening. On the same basis, they will also have to publish, at the end of December, a calendar for the next twelve months (!) setting the dates for the publication of sovereign ratings and corresponding to these, the dates for the publication of related outlooks where applicable. Such dates will have to be set on a Friday. As far as unsolicited sovereign credit ratings are concerned, the number of publications in the calendar will have to be limited between two and three a year. Obviously, the EU has learned from the sovereign crisis of 2010 that nothing has to be left to chance.

Secondly, statements announcing revision of a given group of countries will be prohibited if they are not accompanied by individual complete research reports, provided free of charge. The rating agencies have already alerted the European Member States to the dangers inherent in this idea.[71] The Member States have pledged to no longer ask rating agencies to rate their debt and to no longer compensate them for this service. The agencies, of course, are under no obligation to rate sovereign debt. However, if they are obliged to publish free of charge, in addition to the rating, the research report on which it is based, the agencies have clearly threatened to no longer rate the debt of the EU Member States. If no one is prepared to pay for these interpretative and explanatory reports on credit ratings, the agencies no longer have any interest in issuing the ratings themselves and could very well stop rating the debt of the EU Member States. The future will tell if this "threat" is put into practice once the Proposal for a Regulation is adopted and enters into force.

Thirdly, credit rating agencies will have to explain in their press release and/or reports the key elements underlying the ratings. This exercise is less easy than it appears at first sight since the rating agencies cannot recommend, directly or explicitly, on any national policies of countries or other sovereign entities. Rating agencies will have to assess the credit worthiness of these entities taking into account these policies but they are strictly forbidden to make any political recommendations.

Finally, the proposed regulation introduced in the supervision of credit rating agencies a mechanism which is rare in the field of public law and unknown, to the best of our knowledge, to private companies. If the proposal is adopted as currently drafted, the following new paragraph will be included in the Regulation: "A credit rating agency that intends to change materially existing or use any new rating methodologies, models or key rating assumptions that could have an impact on a credit rating shall publish the proposed changes or proposed new methodologies on its website *inviting stakeholders to submit comments for a period of one month* together with a detailed explanation of the reasons for and the implications of the proposed material changes or proposed new methodologies" (emphasis added). Practically speaking, we cannot see at this stage how this provision will be put in place as no definition exists of what constitutes a "material change" to rating methodologies, models or key rating assumptions. Besides, the term of stakeholder is not defined in the draft regulation. It will therefore be interesting to see how the rating agencies will comply with this new rule which is very symptomatic of the intrusive nature of the Commission's interventions in the rating activity. The position of the Commission has become schizophrenic: on one hand, it affirms it cannot interfere in the rating activity itself, and on the other hand, it includes number of rules which have indirectly this effect. We feel that these kinds of rules may lead the rating agencies to seize the European Court of Justice since it violates fundamental European rules such as the freedom of trade.

4.2 The Introduction of Civil Liability Rules for Rating Agencies

The Regulation did not initially cover the liability of rating agencies, leaving this matter to the Member States.[72] However, it quickly became clear that the EU wished to establish civil liability rules specifically for

70. European Commission, "Public Consultation on Credit Rating Agencies (Consultation Paper)", p. 14; see also the Commission's "Impact Assessment accompanying the document 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 coordination on laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Fund Managers", 8 June 2011, SEC(2011) 1354, 4-5.
71. Fitch Ratings 2010; Moody's 2011; Standard & Poor's 2010.
72. Recital 69 to Regulation 1060/2009: "Without prejudice to the application of Community law, any claim against credit rating agencies in relation to any infringement of the provisions of this Regulation should be made in accordance with the applicable national law on civil liability"; European Commission, "Public Consultation on Credit Rating Agencies", p. 24. At present and to the best of the author's knowledge, only France has amended its national law to implement the Regulation and provides that rating agencies can be held liable before the French courts, French Financial and Monetary Code, Art. L544-5, introduced by the Act of 22 October 2010.

rating agencies.[73] Needless to say, the agencies have strongly objected to this proposal. Fitch,[74] Moody's[75] and S&P[76] have all informed the Commission that they consider the proposal to introduce a standard of liability that is not only useless but also likely to have adverse effects. Their complaints have fallen on deaf ears. If the Proposal for a regulation is adopted, new Article 35a will be inserted in the Regulation, thereby setting a common European standard of civil liability for rating agencies.

4.2.1 The Liability of Rating Agencies in the Proposal for a Regulation of November 2011

New Article 35a of future Title IIIa of the Regulation will cover the contractual liability and liability in tort of rating agencies and can be summed up in three main ideas.

Firstly, a rating agency will be held liable if it intentionally or with gross negligence[77] infringes the provisions of the Regulation and this violation affects a rating on which an investor relied when purchasing the rated instrument. In this case, the investor can lodge a claim against the agency. In the author's opinion, this rule merely states the obvious: a rating agency that commits gross negligence thereby causing harm to an investor can be held liable if the investor's damage is attributable to the negligent act. While the proposed provision refers only to an "impact"[78] and not damage, this is probably not significant as an investor that has realised a profit after the agency's error would be unlikely to take action. The European Parliament had redrafted the provisions of the future section on civil liability in such a way to render them more efficient. However, it appears from the text upon which a political agreement was reached between the European Parliament and the Commission that the initial standard of fault set by the Commission is the one to be included in the Regulation. The justification of the appropriateness of this standard is following the Commission "because the activity of credit rating involves a certain degree of assessment of complex economic factors and the application of different methodologies may lead to different rating results, none of which can be qualified as incorrect".[79]

Secondly, the Commission wished to reverse the burden of proof, indicating that "[w]here an investor establishes facts from which it may be inferred that a credit rating agency has committed any of the infringements listed (...), it will be for the credit rating agency to prove that it has not committed that infringement or that the infringement did not have an impact on the issued credit rating". The question of how an investor can establish and obtain such proof is not addressed, but unless ESMA does so, it is difficult to see how such facts can be proven by an investor based solely on the rating and the accompanying information.

Thirdly and finally, the Proposal for a regulation provides that "any clause in an agreement excluding or limiting civil liability in advance shall be deemed null and void".[80] This is probably the only liability provision which will have concrete effects in practice. While the new provision's effects in terms of extracontractual (tort) liability will be limited, the contractual consequences will be more significant. All ratings agreements typically include exoneration clauses and limitations on liability in favour of the rating agencies. These clauses will gradually disappear and, given the likelihood of litigation against the agencies, recourse will have to be had to contractual liability. Issuers are indeed in the best position to detect a potential error on the part of a rating agency and to be harmed by it.

4.3 The Calling into Question of the Position of Rating Agencies in Europe

The liability rules described above reflect a change in the perception of rating agencies. They are no longer considered to be on the sidelines of the financial markets but rather just another actor on the field and can thus be held liable if their negligence harms others.

The Commission also decided to address the issue of the dependence of credit rating agencies, which it deemed excessive. The Community legislature has thus launched a "detox"[81] programme for the financial markets, which entails doing away with the regulatory role of ratings, developing competition on the ratings market and seeking out new common references. On the other hand, the EU rejected the idea, which generated a cer-

73. European Commission, "Public Consultation on Credit Rating Agencies (Consultation Paper)"; European Parliament, Committee for Legal Affairs, "Draft Opinion of the Committee on Legal Affairs for the Committee on Economic and Monetary Affairs on credit rating agencies: future perspectives", 19 January 2011, 2010/2302(INI); European Commission, "Impact Assessment accompanying the document 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 for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Fund Managers", pp. 18-19.
74. Fitch Ratings 2010.
75. Moody's 2011.
76. Standard & Poor's 2010.
77. The provision was poorly drafted as in somewhat circular terms, it defines gross negligence as follows: "A credit rating agency acts with gross negligence if it seriously neglects duties imposed upon it by this Regulation" (Art. 35a(3)). In the Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No. 1060/2009 on credit rating agencies – political agreement, it is now provided that terms such as damage, intention, gross negligence, etc. shall be interpreted and applied in accordance with the applicable national law as determined by the relevant rules of International Private Law.
78. An infringement is considered to have an impact on a credit rating "if the credit rating that has been issued by the credit rating agency is different from the rating that would have been issued had the credit rating agency not committed that infringement", Art. 35a(2) Proposal for a Regulation.
79. Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No. 1060/2009 on credit rating agencies – political agreement, preamble, para. 25.
80. Art. 35a(5) Proposal for a Regulation.
81. Financial Markets Authority 2010, p. 7.

tain amount of public support, of establishing a public European credit rating agency.[82]

4.3.1 Elimination of the Use of the Ratings Issued by Credit Rating Agencies for Regulatory Purposes

External ratings, namely, those issued by credit rating agencies, are used for many regulatory purposes, pursuant to various pieces of Community legislation.[83] In certain fields, the use of external ratings is optional, and they are only mentioned as one factor amongst others (this is the case in banking circles for the application of the directive on regulatory capital[84] as well as with respect to investments by undertakings for collective investment in transferable securities[85]). *In other areas, however, the use of external credit ratings is indispensable,*[86] *even mandatory.*[87] *It is striking to note in this regard that the actors that rely the most heavily on such ratings are in fact public entities, in particular European public entities, such as the European Central Bank*[88] *and the European banking, insurance and pensions authorities as well as the financial markets*. Even the Commission is not immune from this practice, as it uses ratings for the purpose of assessing state aid.[89]

A directive was adopted in June 2011[90] which requires credit institutions, investment companies, non–life insurance companies, life insurance companies, reinsurance companies, UCITS, institutions for occupational retirement provision, and alternative investment funds to use for regulatory purposes only credit ratings issued by rating agencies established and registered in the EU.[91] This directive was only the first step, however, as the Commission published at the same time as the Proposal for a Regulation amending Regulation No. 1060/2009 a proposal for a directive intended to amend the directives on UCITS and alternative investment funds. If this proposal is adopted, such funds will no longer be able to rely mechanically and uniformly on credit ratings, which they must consider as "one factor among others".[92]

4.3.2 The EU's Search for New References

The Commission's deadline is the end of 2013. By this time, the EU's principal financial regulators, namely ESMA, the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA), should have been able to modify their orientation, communications and other technical standards so that financial markets participants and the authorities themselves no longer rely mechanically on external credit ratings. The Proposal for a Regulation does not mention, however, what should replace the numerous references in Community law to credit ratings.

Moreover, by 1 January 2020, all references to ratings will have to be eliminated from Union law if these references are likely to trigger or have the potential to trigger sole or mechanistic reliance on credit ratings by competent authorities or financial market participants. At this stage, non–proposition had been made by the Commission of another EU's principal financial regulators as regards alternative references to rating. New Directive and Regulation will most likely enter into force in 2013 which means that the EU will thereafter have seven years to find an efficient substitute to ratings and to amend all European Acts including them. Let us wait to 2020 to see if the Commission has taken up its challenge.

82. *Echos* 2010; *Le Monde* 2010; for the position of Jean-Pierre Jouyet (head of the AMF, the French securities regulator), see Reuters, "Jouyet (AMF) ne veut pas d'une agence de notation européenne", 4 May 2010; Echos 2011. At the time of writing, this proposal is still mentioned in numerous programmes and political debates, see for example the programme of François Hollande. Available at: <http://francoishollande.fr/actualites/agence-publique-de-notation-europeenne/>; see also "Draft Report on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) No. 1060/2009 on credit rating agencies", which asks the Commission to prepare a "report on the establishment of a fully independent public European Credit Rating Agency assessing the creditworthiness of Member States' sovereign debt. That report should identify whether an existing institution could perform the task of rating sovereign debt. The report should include, if appropriate, a legislative proposal", PE480.852, 15 February 2012, 14-15.
83. For a list of such provisions in the Community financial law regulations, see European Commission, "Public Consultation on Credit Rating Agencies (Consultation Paper)", pp. 29-32.
84. Directive 2006/48/EC of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions, [2006] OJ L 177, Annex VII, Part 2, Art. 7(d).
85. Directive 2007/16/EC of the Commission on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions, [2007] OJ L 79, Art. 6(3).
86. Thus, with respect to insurance and reinsurance, while the Community solvability directives do not require the use of external ratings, the Commission found that many Member States have transposed the directives so as to refer to such ratings. The same finding was made for the transposition of Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision. European Commission, "Public Consultation on Credit Rating Agencies (Consultation Paper)", pp. 29-32.
87. With respect to investment firms, Art. 18(2) of Commission Directive 2006/73/EC of 10 August 2006 implementing MiFID as regards organisational requirements and operating conditions for investment firms defines a "high quality" money market instrument as one that has been awarded the highest available credit rating by each competent rating agency which has rated that instrument. In practice, this means that qualifying money market funds, which are a form of undertaking for collective investment, can only invest in instruments that have received the highest credit ratings. With respect to the prospectus for a public offering or admission to trading on a regulated market, the prospectus for debt securities must mention the rating awarded to the debt, if such a rating has been issued (see Annex V, Art. 7(5) of Regulation EC (No) 809/2004 implementing Directive 2003/71/EC as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, [2004] OJ L 149).
88. For a detailed description of the use of external credit ratings by the ECB, see Coppens *et al*. 2007.
89. Proposal for a Regulation, p. 32.
90. 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. 1060/2009 and (EC) No. 1095/2010, [2010] OJ L 174, pp. 1-73.
91. Art. 4(1) Regulation No. 1060/2009.
92. Proposal for a Directive, pp. 5-6.

4.3.3 Abandonment of the Plan to Establish a Public European Credit Rating Agency

Of the abandoned measures, the one calling for the establishment of a European credit rating agency is undoubtedly that which has received the most coverage.[93] The EU, however, appears to have finally relinquished this plan. The reasons that pushed the Commission to do so are multiple: in particular, it did not wish to disrupt competition on the ratings market, hinder the entrance of new participants or give rise to conflicts of interest with respect to the ratings of sovereign debt.[94] The establishment of a standard rating scale by ESMA nonetheless meets, to a great extent, the objective behind the creation of such an agency, namely, it gives the public authorities a foothold on the ratings market.

5. Conclusion

This article presents the current and future statutory framework for ratings agencies in Europe. Initially closer to the markets, the agencies operated for quite some time in accordance with the principle of self-regulation. The recent financial and economic crises dealt a fatal blow to this practice, however. While the date of adoption of the proposed regulation and directive is not yet known (most likely in the course of the first six months of 2013), the EU clearly intends to progress as quickly as possible when it comes to the regulation of credit rating agencies.

While new control mechanisms and forms of oversight will be introduced and strengthened, to the displeasure of some, the EU does not intend to force rating agencies to shut their doors or end their activities altogether. Rather the new rules may even serve to strengthen their position through the elimination of their unquestioned role in the markets. Rating agencies will henceforth be regulated as other actors in financial circles, but their right to exist has not yet been called into question.[95]

The Union's already considerable framework to protect investors from the uncontrolled and unforeseeable effects of the market could be further extended. The EU holds rating agencies liable for the deterioration of the markets, and they undoubtedly played a role in this regard, but they are not solely responsible for accelerating the effects of the crisis.

The EU's objectives are indeed ambitious. The establishment and implementation of prudential supervision of an activity as intense and specialized as credit rating require time and skill. It remains to be seen if, given the increase in the number of documents to be submitted to ESMA, the 28-person[96] team entrusted with overseeing rating agencies will be able to properly perform its duties and above all if such supervision will actually prevent in the future crises of a scale similar to those which have shaken Europe and the rest of the world in these past few years.

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93. Proposal for a Regulation, pp. 11-12.
94. *Ibid.*; see also "Impact Assessment accompanying the document 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 coordination on laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Fund Managers", pp. 41-42.
95. As evidenced by the bestowal in January 2012 of the 2011 regulator of the year award on the trio of Moody's, Fitch and Standard & Poor's by the French business newspaper, *Le Nouvel Economiste*, see the article available at: <www.lenouveleconomiste.fr/journal-numerique/consultation-1592-politique_economie-manager.html>; see *also* the reaction of the managing director of Moody's France, Eric de Bodard, to this announcement, "L'importance de reconstruire la confiance dans les marchés de crédit et la régulation des agences de notation", available at: <www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_138437>.
96. ESMA, *2013 Work Programme*, ESMA/2012/631, 20, 11. See also the recent reaction of the General Assembly of the United Nation in its report on "External debt sustainability and development" (Report of the Secretary-General, 24 July 2012, A/67/174, para. 26).

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