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Position of DAI, BDI and VDT on the European Commission's draft for a Regulation of the European Parliament and of the Council amending Regulation (EC) no. 1060/2009 on credit rating agencies

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Introduction

Deutsches Aktieninstitut (DAI)[1], Bundesverband der Deutschen Industrie (BDI)[2] and Verband deutscher Treasurer (VDT)[3] set out in this paper their joint position on the European Commission's proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) no. 1060/2009 on credit rating agencies. Our position represents the view of corporates which depend on rating agencies to successfully issue bonds on capital markets.

Rating agencies perform a decisive macroeconomic function. With their analyses, they provide market participants with (usually) publicly available information on the credit-worthiness of bond issuers. This reduces the cost of credit analysis and gives issuers an incentive to improve (or maintain) credit-worthiness in order to signal a good rating to the market and hence to ensure smooth bond issuing. All in all, efficiently functioning rating markets increase liquidity on capital markets, improve companies' financing possibilities and enhance investors' alternatives to invest their money on capital markets. Any approach to regulate rating agencies should ensure that this valuable function can be maintained by rating agencies in future.

The rating market especially regarding bonds issued by corporates is accepted by investors and issuers alike. The EU Rating Regulation (No. 1060/2009) adopted in 2009 made a further contribution to this. We welcome the EU-Commissions' aim to foster own risk assessments and internal risk management instruments recognized by supervisory authorities for regulatory purposes especially in the financial sector. The overarching goal of any regulatory initiative should be to decrease over-reliance of market participants on the assessment of rating agencies, which was by and large promoted by the legislator's approach to acknowledge rating grades in several regulations.

Nevertheless, one should be aware that ratings will be important for issuers and investors in the future as well. Several of the EU-Commission's proposals would impair the efficiency of the market for corporate bond rating. The implementation of these proposals would remarkable deteriorate corporates' financing conditions and therefore harm both investment and job creation.

[1] The Deutsches Aktieninstitut e.V. (DAI, www.dai.de) is the association of German exchange-listed stock corporations and other companies and institutions which are engaged in the capital markets development.

[2] The Bundesverband der Deutschen Industrie e.V. (BDI, www.bdi.eu) is the umbrella organisation of German industry and industry-related service providers. It represents 38 industrial sector federations and has 15 regional offices in the German Länder. BDI speaks for more than 100,000 private enterprises – 98 % small and medium sized – employing around 8 million people. Membership is voluntary.

[3] The Verband Deutscher Treasurer e.V. (VDT, www.vdtev.de) is the official German association of Corporate Treasurers representing more than 950 treasury professionals from 450 companies.

We are aware that the role of rating agencies in the financial crisis especially regarding structured finance products should not escape all criticism. Many of the securitised loans assigned the best ratings were downgraded to sub-investment status in a very short period of time. Accordingly, supervisory authorities have already adequately and successfully drawn regulatory conclusions in the ratings regulation, inter alia through a labelling obligation for the ratings of structured products.

Therefore, there is no reason to cast doubt on the efficiency of the rating market in its entirety, especially including the rating of corporate loans, since these instruments have not contributed to the financial crisis. However, the EU-Commission finds functioning deficits across the board and formulates regulatory proposals on this empirically unsubstantiated basis. On closer examination, the arguments advanced by the EU-Commission do not stand up to scrutiny:

- Ratings for companies are in stress situations far more stable than ratings for structured products from the sub-prime segment. For instance, in 2001, when there were an above-average number of corporate rating downgrades as compared with the rating for the previous year, only 6% of BBB-rated companies were downgraded (the downgrade was mostly only just one notch). By contrast, in 2007 and 2008, 68% of BBB-rated financial instruments in the sub-prime residential mortgage-backed securities market segment were downgraded, to a large extent by more than three notches. The massive downgrading in this segment is strong evidence of deficits in the assessment of securitised US real estate loans, including methodological inadequacies. Evaluating the credit-worthiness of companies is not comparable and takes place on the basis of methods which have been tried and empirical approved over decades.[4]

- In the discussion on regulation of the rating market, particular emphasis is placed on conflicts of interest which arise from the "issuer-pays" model. Nevertheless, it can be shown that this compensation model does not as a rule lead to the situation that the issuer "buys" a high and preferably "favourable" rating. Rather, the facts indicate that the rating agencies tightened up their evaluation standards when this payment model was adopted in the 1970s in order not to jeopardise their reputation as their most important asset among investors. It can be demonstrated that the credit ratings for US companies from the mid-1970s to the mid-1990s fell on average. In other words, the rating agencies started to assess companies more conservatively even though they are paid for the rating by the issuers themselves.[5] Furthermore, as a rule, rating agencies react without long delays to a deterioration in the credit-worthiness of an issuer. Yet a lower credit rating is not in the interest of issuers, since this exacerbates the financial situation. The existence of a conflict of interest would therefore imply the reverse, i.e. that a downgrade would follow the deterioration in credit-worthiness only after a perceptible delay.[6]

- In addition, investors are largely satisfied with the evaluations of rating agencies. Reflecting this, the entry of new rating agencies into the market has not led to a shift of market shares; the natural oligopolistic structure remained. For instance, after

[4] See International Monetary Fund: Global Financial Stability Report, April 2008, page 61 et seq.

[5] See Blume, Marshall E. et al.: The Declining Credit Quality of U.S. Corporate Debt: Myth or Reality? in: Journal of Finance 53, 4, 2008, pages 1389-1413.

[6] See Covitz, Daniel M. / Harrison, Paul: Testing Conflicts of Interest at Bond Ratings Agencies with Market Anticipation: Evidence that Reputation Incentives Dominate, Working Paper, Washington 2003.

Enron became insolvent in 2001, numerous rating agencies were authorised by the SEC as "national recognized statistical rating organizations" inter alia to foster competition and hence acquired a supervision quality label to a certain extent. But this regulatory upgrade did not change market shares of the established rating agencies Moody's, Standard & Poor's and Fitch.[7] Were investors not satisfied with the recent market structure they would have forced issuers to contract with alternative rating agencies. Issuers would have reacted on these demands in order to not threaten their primary aim on which the purchase of the rating assessment is based: the acceptance of the bond issue among investors.

The current discussion on a tightened regulation of the rating market suffers not only because it clearly misevaluates the importance and functioning of the rating market; it also disregards the fact that rating agencies, the legislator, and investors have learnt the appropriate lessons from the crisis:

- Rating agencies have improved, inter alia, rating processes, transparency and internal corporate governance.

- Due to a range of legislative initiatives both regulation and supervision of rating agencies have been bolstered. These include in particular the 2009 EU rating regulation, which was amended in mid of 2011. Among other things, this incorporates a registration procedure, various measures to reduce or avoid conflicts of interest, transparency requirements e.g. for the applied methodologies, a labelling obligation for unsolicited ratings, the right of the supervisory authority to carry out on-site inspections, and, as a last resort, licence withdrawal.

- Investors now monitor ratings much more closely, to avoid the charge that they blindly accept the evaluations of rating agencies. Nevertheless, to improve investors handling of ratings it should be clarified that the labelling obligation of unsolicited ratings incorporates also ratings which can be found on the agencies website. As a rule investors base their credit analysis on information provided by news agencies like Bloomberg and Reuters which in turn get their information from the websites of the rating agencies. Unfortunately, this website information does not differentiate between solicited and unsolicited ratings because rating agencies claim that they are not obliged to do so. As a result misinterpretations among investors are a common problem. Corporates do intentionally contract with rating agencies which gain insider status and will be therefore informed by the company's management about the strategy, outlook, liquidity situation and transactions of greater importance on a regular basis. In this dialogue, which comprises also non-public information, companies and rating agencies ensure that the credit assessment is from high quality which is pivotal for the above mentioned acceptance among investors. Unsolicited ratings are lacking this quality claim. Therefore, rating agencies should label them unambiguously irrespective of the communication medium they use.

Altogether, there have been a series of developments which take into account the recognised inadequacies in the rating market. For regulatory measures which go beyond the rules already adopted, it is therefore important to bear in mind that an overly dense regulatory net would be detrimental to the above-described efficiency of the rating market and hence would cause more harm than good to the economy. Against this background we are concerned that many of the EU-Commissions' proposals could deteriorate the attractive-

[7] See Hill, Claire H.: Why did Rating Agencies do such a bad Job rating Subprime Securities? in: University of Pittsburgh Law Review 71, 3, 2010, pages 585-608.

ness of rating for issuers and investors to such a degree that the willingness to contract and pay for ratings will be diminish considerably. This would deteriorate efficiency and competitiveness of European bond markets significantly.

This applies in particular for the EU-Commission's intention to increase competition in the rating market through mandatory external rotation which would hinder the issuer to contract with one of the rating agencies that are well established in the market. Lower rating quality and a reduction of corporates possibilities for financing would be the result (see point 1 below). Neither should the aspiration to make investor decisions more independent of ratings agencies lead to issuers being forced to publish confidential data. As a result, the issuer would refrain to hand over this information to the rating agency at all. A rating based only on public available information is of much lower quality than a rating which comprises additional information (see point 2 below). Furthermore, it is to be feared that very wide-ranging measures such as an obligation for structured products to have a second rating or liability rules would markedly increase the cost of a rating without generating an additional benefit (see points 3 and 4 below). We also take a critical stance on far-reaching competences for ESMA (see point 5 below).

1) External rotation (art. 6b)

In order to avoid closeness to rating analysts and/or rating agencies and the associated potential conflicts of interest, the EU-Commission's proposal provides for an obligation to change rating agency after a maximum of three years. The rating agency must be changed after just one year if ten issues have been rated in succession. If the issuer has solicited more than one rating agency, the rules on external rotation will only apply for one of them. But a rating agency may not have contractual relations with an issuer for a total of more than six years. After the change, a "cooling-off" period of at least four years is foreseen, until the rating agency can be mandated again.

This provision is ineffective for various reasons and should therefore be rejected:

- External rotation is likely to deteriorate rating quality: the proposal for external rotation copies a regulatory idea from the audit market, whose effectiveness has been extensively investigated in a number of empirical studies. Almost unanimously, these studies come to the conclusion that a statutory requirement to change the auditor would lead to a significant increase in auditing errors, clearly reducing the quality of the audit certificate.[8] A similar outcome can be feared in the rating market. Thus, experience shows that a rating analyst needs at least two years to acquire the necessary knowledge to be able to evaluate larger and more complex companies. The expertise of rating agencies accumulated over many years in a business relationship would be lost as a result of external rotation. Both the quality and reliability of ratings would be clearly diminished. The "handover file" proposed by the EU-Commission will not change anything (art. 6a para. 6).

- A reduction in information quality is likely: external rotation is supposed to increase competition between rating agencies by obliging issuers by law to solicit alternatives to the established rating agencies. But it is questionable whether an increase in competition also results in a higher rating quality, not least because of the absence hitherto of alternatives to the established large rating agencies which are accepted by investors. Today large issuers regularly solicit two rating agencies in order to

[8] See Cameran, Mara et al.: The Audit Firm Rotation Rule: A Review of the Literature, Working Paper, SDA Bocconi, September 2005.

gain acceptance in the market. For non-financial companies these are Standard & Poor's and Moody's as a rule. As a consequence of the proposed provision, one of these would have to be changed after three years at the latest followed by a cooling-off-period of four years. During this period, it can be assumed that the rating agency Fitch will be solicited, which still has a comparable reputation. Yet the second rating agency must also have a pause after at most six years. In this example, the consequence is that Fitch alone among the three large rating agencies would be eligible to give a rating in the seventh year. Therefore, an issuer which prefers to contract with two rating agencies furthermore must have four rating agencies available. Issuers which yet contract with three rating agencies should have six rating agencies available under the rotation rule.

The mandatory external rotation would harm the quality of information since the issuer is forced to contract exclusively with one remaining established rating agency and is therefore forced to resign from a second rating. Otherwise, it has to mandate one of the smaller rating agencies, which have hitherto as a rule specialised on particular companies or particular sectors and hence do not currently constitute an alternative. There are also clear doubts as to whether these rating agencies can build up the necessary human resources and data bases to validly estimate e.g. default and transition probabilities they would need to be able to evaluate companies outside their present range of competence. More important is also the fact that they are not accepted by investors until now.

- Rating clauses in contracts: Many contracts agreed by issuers (e.g. long term supply and delivery agreements) require a certain level of minimum rating from a – in many cases – contractually determined rating agency. In addition, loan contracts often incorporate a rating clause which frequently also determines the interest rate. So called change-of-control-clauses, which become relevant in a take-over situation, grant bond holders the right to terminate the bond contract and force the issuer for redemption if the rating falls below a certain threshold. Furthermore, regulatory approval, e.g. concession contracts in the energy industry, necessitates the proof that the company obtains a rating from one of the established rating agencies. To switch the rating agency mandatory and to mandate a "no-name" agency would imply a breach of the contractually agreed conditions because no business partner can be forced to accept another rating agency as defined in the contract. Due to differing methodologies (e.g. regarding hybrid bonds – see below), the change of the rating agency would also affect the rating grade which might impact the conditions agreed in the contract (e.g. the interest rate). A prohibition of these contract clauses to solve these problems is not acceptable and would be a serious threat to the freedom of contract.

- Upward pressure on prices cannot be ruled out: quite apart from this, the external rotation rule would probably increases prices charged for rating services, since each of the three large rating agencies could be certain of being solicited by an issuer at some point of time.

- Counterproductive for investors: investors usually invest in corporate bonds for longer than three years ("buy and hold"). A change of rating agency after at most three years would have the consequence that the rating at the time of the investment decision would differ from the rating over the period during which the bond is held. There is e.g. no consent among rating agencies to which degree hybrid capital is acknowledged as equity. The different treatment of hybrid capital is reflected in

the different rating degrees. Hence, due to the pure fact that different methodologies were applied the obligatory change of the rating agency might significantly alter the rating grade. This mandatory frequent change means significant additional monitoring costs for investors, given that the evaluations of the different rating agencies are conditionally comparable. This problem can't be solved by the proposed introduction of the European Rating Index ("Eurix"). On the contrast, such a common index would bear the risk that investors will rely on some kind of average rating and would suggest that a differentiated analysis of the various ratings the index is based on and especially an own assessment of the borrowers credit worthiness is not necessary anymore.

- The detrimental effect of the "issuer-pays" model has not been proven: The EU-Commission justifies the introduction of the mandatory external rotation rule with disadvantages stemming from the issuer-pays-model. To avoid potential conflicts of interest the EU-Commission still favours the investor-pays-model, which has however various unsolvable shortcomings. Regarding this model the problem remains how to provide the "public good" rating exclusively for investors who are willing to pay for it. One should also be aware that the transition to the investor-pays-model will also lead to conflicts of interest, especially resulting from the investors' own interest to get a lower rating grade because this would imply higher interest payments. Against this background the issuer-pays-model remains the option which is relative best among the different remuneration models.

- The existing rotation rule is sufficient: moreover, the rating regulation already provides for internal rotation, i.e. the mandate for both rating analysts and the individuals who authorise the rating is limited in time (annex I, section C, no. 8). The rotation cycle for leading rating analysts is four years, for instance. Since the rating regulation entered into force in 2009, the first rotation does not fall due until 2013. Before further regulatory steps are initiated, the effectiveness of internal rotation should be analysed thoroughly.

In total, the external mandatory rotation is a very wide-ranging interference in the rating market; due to the several fundamental disadvantages described above it should not be introduced.

2) Disclosure requirements

The European Commission's proposal makes provision for various disclosure requirements for issuers and rating agencies:

- Annex 1, section D, part 1, point 2a: hitherto the rating regulation lays down that the rating agency must publish all information that it has received for rating a structured product for the their initial review or for preliminary rating. This provision would be extended to issuers and ratings of all debt instruments. It would apply for all entities or debt instruments irrespective whether the issuer contracts with the rating agency. Furthermore, the rating agency should be obliged to explain their premises, parameter, limiting values and uncertainties and to disclose their simulation results of their stress testing.

- Article 8a: issuers of structured products would have to make available a range of information which would be published centrally on an ESMA home page. This includes in particular "information on the credit quality and performance of the individ-

ual 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".

In the European Commission's view, both rules would help either to place the investor in a position to evaluate the credit-worthiness of the financial instruments in question or to increase competition among rating agencies from unsolicited ratings. These additional disclosure requirements should be rejected for the following reasons:

- Issuers also give the rating agencies they solicit confidential information which is not subject to disclosure requirements and which is indispensable for a substantiated rating (e.g. target figures). It is of central importance that the issuer itself can determine who gains access to this information. In the framework of a rating that it has solicited, both of these conditions are met, because rights and obligations of both parties are regulated by contract. If they were made public, data which are relevant for ratings could be consulted by anyone, including competitors of the issuer. The consequence is that issuers would make less information available to the agencies they solicit, causing the quality of the rating to reduce markedly as compared with the current situation. In extreme the issuer would provide information only which is publically accessible. The benefit of a rating which is based on this information is restricted so that the willingness of issuers to pay for it is limited. In addition, disclosure of yet not published corporate data might collide with other transparency obligations (e.g. ad-hoc-reporting requirements).

- We are also critical of the EU-Commissions' approach of increasing competition between rating agencies through unsolicited ratings. Depending on the rating concept, there are differences between the information needs of the individual agencies which are often crystallised in regular dialogue with the issuer. Therefore, issuers provide similar but not the same information to put the rating agencies in the place e.g. to compute the level of debt with their specific methodologies. In addition, the rating is not prepared exclusively on the basis of "hard" quantitative criteria. Also important is the analysis of the quality of management or the strategy and competition position. Reaching a judgment on this is conditional on a knowledge of the company, of its management and of the relevant markets, which is also acquired locally in analytical discussions. Both of these points make it clear how important dialogue between rating agency and issuer is, which is not possible in the case of unsolicited ratings. A rating analysis which is based only on publicly accessible information is therefore insufficiently well founded. Thus, unsolicited ratings can never achieve such high quality as solicited ratings. This is also confirmed by empirical studies.[9]

  Quite apart from this, experience shows that the publication of unsolicited ratings is used by some rating agencies in order subsequently to secure a contract for a detailed solicited rating. The consequence is that unsolicited ratings are often deliberately of lesser quality so that a "correct", i.e. better rating can be prepared once the corresponding contract has been awarded. Conversely, an unsolicited rating might be too positive in order to qualify for an "official" rating contract. Both would be an-

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9 See Poon, Winnie P. H. / Chan, Kam C.: Solicited and Unsolicited Credit Ratings: A Global Perspective, ADBI Working Paper Series, No. 244, Asian Development Bank Institute, August 2010, in particular the comprehensive literature overview on page 2 et seq.

ticipated by investors and would also justify severe doubts on the quality of unsolicited ratings. In addition, one can hardly imagine that unsolicited (and therefore not paid) ratings will become part of the business model of rating agencies to a larger extent.

- It is also important not to disregard the additional cost and effort for issuers that would be associated with preparing the information called for in art. 8a.

For reasons of confidentiality, the idea that the rating agency should publish for each client the level of fees charged for ratings and other services (annex 1, section E, part II, point 2) should be opposed. Rating agencies' charging policy is essentially already sufficiently transparent. The additional benefit of this disclosure requirement is not self-evident.

3) Mandatory second rating for structured products (art. 8b)

Issuers of structured products should in future be obliged to solicit at least one independent rating in addition to the first rating. By way of justification, the EU-Commission states that the second rating would help to restore the trust in structured products that was lost with the financial crisis. Furthermore, the investors' over-reliance on ratings would be reduced.

Neither justification is coherent for the following reasons. An obligatory second rating is counterproductive because:

- A condition for the successful issuing of a structured product is the willingness of investors to acquire these securities. It has been shown that, as a lesson from the financial crisis, investors are now more sceptical about the rating of structured products which they evaluate more critically than before. For the issuer, this gives rise to the need for a second rating if investors would be unwilling to invest without it. Yet current practice of securities underwriting shows that, as a rule, investors do not demand a second rating for structured products. Accordingly, a statutory obligation to solicit a second rating would largely disregard investors' needs and would unnecessarily increase capital costs for issuers. For this reason, issuers should continue to be able to decide flexibly whether or not they solicit a second rating, as a function of investor wishes.

- In certain segments of the market for structured products, there is often only one rating service provider which has the necessary resources to evaluate these products adequately. It cannot be expected that further providers which can meet the necessary requirements will emerge in the short term. The reliability of a second rating would be poor if the second rating agency is not in a position to assess the product properly.

- Moreover, there is no guarantee that an obligatory second rating would actually reduce the over-reliance of investors on ratings. On the contrary, a second rating could suggest an additional assurance to investors in their investment decision, which would run counter to the original intention of the rule.

4) Liability of rating agencies (art. 35a)

The competences of supervisory authorities are already extremely comprehensive with the adoption of the 2009 rating regulation. For instance, provision is made for on-site inspec-

tions, imposition of fines and licence withdrawal in the case of heavy infringements of the rating regulation. Against this background it is questionable what added value a civil liability vis-à-vis the investor for breaches of the rating regulation would have. Fear of liability claims could cause rating agencies to issue unduly cautious ratings which understate the actual credit-worthiness of the issuer. Furthermore, the cost of potential liability claims against rating agencies would be reflected in the fees charged to issuers for a rating. This could significantly increase the cost of ratings and would unjustifiably increase issuers' financing costs.

For several reasons the proposed civil liability rules are too far-reaching and not justified:

- A mere reliance on the rating should not be sufficient to raise liability claims. If at all, the investor has to prove that the decision to invest based on the assessment of the rating agency materially.

- A liability claim has to prove clear without ambiguity that the damage caused to the investor resulted from an infringement of the rating regulation by the rating agency. To lead this proof would be nearly impossible in practice. One has to differentiate clearly into damages resulting from a worsened creditworthiness or from changes in interest or currency exchange rates, which lie outside the responsibility of the rating agency, and damages that occur from intentionally or gross negligence infringements of the rating regulation. We do not know how to separate these to different issues, which would be nevertheless from greatest importance to handle the liability case in practice.

- The proposal that the rating agency is obliged to prove that it does not infringe the rules of the rating regulation intentionally or in gross negligence is not justified and would lead to the situation that rating agencies would assess companies deliberately too conservative to avoid claims of investors. This is not acceptable from an issuer point of view because the proposed civil liability regime would increase the barrier to entry on the rating market or prevent the entry of competitors at all. As a result, rating fees would rise in many cases. One should also bear in mind that rating agencies might refrain from a rating especially from companies which are not yet well established on capital markets in anticipating potential claims of investors. Such a limitation of rating supply would in particular restrict the possibilities of small and mid cap companies to access capital markets by issuing bonds and would contradict the explicit goal of the EU-Commission to improve financing conditions of these companies.

The European Commission's proposal that an exclusion of liability from contracts between issuer and rating agency should be declared null and void (article 35a paragraph 5) is also viewed critically. For reasons of legal certainty, it would have to be clarified that this provision should not apply to existing contracts.

5) Competences of ESMA

ESMA still has far-reaching supervisory competences regarding e.g. licence withdrawal, enforcement of corporate governance rules etc. The EU-Commission now proposes that ESMA should be empowered to approve new methodologies used by the rating agency, substantiated by criteria which would have to be specified in technical standards in accordance with art. 22a para. 3, also attract criticism. Insofar as the competences of ESMA are restricted to the verification of the formal requirements laid down in the rating regulation

such a measure can increase integrity and reliability of the rating agency. This should be ensured by now because the rating regulation foresees the obligation that rating agencies should disclose methodologies and material changes of them. We reject further supervisory interferences especially with respect to the content as too wide-ranging, since it can lead to a regulatory standardisation of rating methods. This is also acknowledged by the “non-interference-clause” laid down in art. 23 of the rating regulation. The efficiency of rating methods should be decided not by the regulatory authority but by competition between methods on the rating market. The obligation to seek authorisation from ESMA would be detrimental to this competition and hence to the quality of rating methods. Furthermore, it should be doubted that the knowledge of ESMA and other supervisory authorities is superior to the competences of rating agencies active on the markets for many decades.

In addition, ESMA is supposed to assess the risks associated with the existing degree of concentration on the rating market and to take a stance on this in a report (art. 21c paragraph 5). The consequence could possibly be that ESMA could restrict the market shares of established rating agencies, even if this is not mentioned explicitly. From the angle of regulatory policy, this would be an extremely far-reaching intervention in a functioning market. Furthermore, competition questions should anyway not be addressed by ESMA but by national or European antitrust authorities. ESMA should focus on market abuse.

Conclusion

The analysis of the market for corporate ratings shows that this is a functioning market segment from the perspective of investors and issuers alike. Moreover, tightening the regulatory screw therefore lacks all justification. Rather, it is to be feared that the European Commission’s proposals would make it more difficult to use ratings, reduce the quality of ratings and hence also diminish their value for companies seeking capital. In extreme issuers would refrain from contraction with rating agencies which would lead to investors having to take less well informed decisions. This would lead to increasing cost of capital and decreasing corporate earnings. Instead, the European Commission should accept that the three large rating agencies Standard & Poor’s, Moody’s and Fitch yet occupy a dominant market position partly because their assessments in particular regarding corporate ratings have broadly delivered correct ratings over many years.