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Assessing the proposed third EU regulation on credit rating agencies – The issuers' view

Jan Bremer, Deutsches Aktieninstitut

Bruegel, 16 March 2012

General remarks

- Regulatory debate lacks differentiation
- Failure of rating agencies in a specific segment (US-sub-prime structured finance products) should not be taken as reason to blame the entire rating market. Especially the rating market for corporate bonds is well functioning and did not contribute to the crisis at all
- Shortcomings has been sufficiently addressed by the existing EU Rating Regulation which already imposes very far-reaching measures (e.g. registration process, licence withdrawal etc.)
- There is no need for further regulatory action from a corporate bond issuers point of view

Assessing CRA III – The general aims

- Enhance competition: More competition in the rating market should decrease rating fees.
- „Over-reliance“: Investors should regard rating degrees as input information for their own credit worthiness analysis
- Criticism on the issuer pays model is not justified
  - Potential conflict of interests are already well adressed by the EU Rating Regulation
  - After the adoption of the issuers pays model in the 1970ies rating assessments became more conservative

Assessing CRA III – External rotation

- *Issuer is required to change the rating agency after three / six years*
- External rotation is likely to…
  - …decrease competition among the „Big-3“
  - …decrease rating quality
- Other issues which require continuity of the rating assessment: E.g. contract clauses referring to a certain rating agency
- A rotation rule is already enacted (internal rotation)

Assessing CRA III – Disclusure requirements

- *Information submitted by the issuer for the initial or preliminary rating shall be disclosed on the rating agencies website (inter alia to foster competition by unsolicited ratings)*
- For reasons of confidentiality the issuer will refrain from providing the rating agency with information which is not (yet) publicly available. As a consequence rating quality is likely to decrease
- Unsolicited ratings have a lower quality than those which are mandated by the issuer

Assessing CRA III – Liability regime

- *Rating agencies should be liable for infringements of the Rating Regulation committed intentionally or with gross negligence; reversal of evidence*
- General problem: How to differentiate between rating failures caused by e.g. a change of macroeconomic environment and those caused by an infringement?
- Issuers are concerned that rating agencies…
  - …will become overly conservative in their assessment
  - …will pass on expected costs for litigation and increase rating fees
- The existing Rating Regulation provides sufficient measures to „incentivice“ rating agencies to comply with the rules

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