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# Council adopts new rules on credit rating agencies

The Council today[1] adopted a directive and a regulation amending the EU's rules on credit rating agencies (CRAs) (*69/12* and *70/12*).

Adoption of the legislation follows agreement reached with the European Parliament at first reading on 27 November 2012, and subsequent approval by the Permanent Representatives Committee on 5 December 2012.

The directive and regulation amend existing legislation on CRAs in order to reduce investors' over-reliance on external credit ratings, mitigate the risk of conflicts of interest in credit rating activities and increase transparency and competition in the sector.

Specifically, the directive amends current directives on the activities and supervision of institutions for occupational retirement provision[2], on undertakings of collective investment in transferable securities (UCITS)[3] and on alternative investment funds managers (AIFM)[4] in order to reduce the institutions' reliance on external credit ratings when assessing the creditworthiness of their assets.

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1 The decision was taken without discussion at a meeting of the Agricultural and Fisheries Council.
2 Directive 2003/41/EC.
3 Directive 2009/65/EC.
4 Directives 2009/65/EC and 2011/61/EU.

P R E S S

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The regulation[1] introduces a mandatory rotation rule obliging issuers of structured finance products with underlying re-securitised assets who pay CRAs for their ratings ("issuer pays model") to switch to a different agency every four years. An outgoing CRA will not be allowed to rate re-securitised products of the same issuer for a period equal to the duration of the expired contract, though not exceeding four years.

But mandatory rotation will not apply to small CRAs, or to issuers employing at least four CRAs each rating more than 10% of the total number of outstanding rated structured finance instruments.

A review clause provides the possibility for mandatory rotation to be extended to other instruments in the future. Mandatory rotation is not a requirement for endorsement by the EU of third country CRAs.

Due to the complexity of structured finance instruments and their role in contributing to the financial crisis, the regulation also required issuers to engage at least two different CRA for the rating of structured finance instruments.

To mitigate the risk of conflicts of interest, the regulation requires CRAs to disclose publicly if a shareholder with 5% or more of the capital or voting rights holds 5% or more of a rated entity.

And to ensure the diversity and independence of credit ratings and opinions, the regulation prohibits ownership of 5% or more of the capital or the voting rights in more than one CRA, unless the agencies concerned belong to the same group.

Under the rules approved today, investors or issuers will be able to claim damages from a CRA if they suffer a loss due to an infringement committed by the agency intentionally or with gross negligence.

Moreover, sovereign ratings will have to be reviewed at least every six months (rather than every 12 months as currently applicable under general rules).

The regulation calls on the Commission to prepare a report by 1 July 2016, reviewing the situation in the credit rating market, and if necessary to follow it up with appropriate legislative proposals on some of the new provisions.

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[1] Regulation amending regulation 1060/2009