Dipartimento di Economia E Finanza, Cattedra di Financial Markets Law and Regulation. Corso di Laurea “ Financial Economics”

“THE EUROPEAN REGULATION OF CREDI RATING AGENCIES”

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Sommario

INTRODUCTION

Credit rating agencies are independent providers of credit opinions . Their main business is analysing business or governmental information and then issuing an opinion on the creditworthiness of a company, a government or other financial debt instrument. This opinion, called ratings, are closely expected by various operators in the market such as investors, governments, borrowers and issuers.

For the last 20 years, Credit Rating Agencies (CRAs) have been playing an increasing key role on financial markets. Issuers and investors depend both on the information created by CRAs helpful to determine the financing cost and afterwards could influence buying and selling decisions.

The growing importance and influence of this agencies can be explained by:

- the increase size and structure of financial markets participants;

- the shift of credit’s supply from banks to capital markets;

- the continuous creation of new and often complex financial products;

- the complexity and diversity of investment strategies of these participants;

- increased reliance of sovereigns on bond financing; and,

- finally, the fact that actors in the market are offered a time-saving and comparative tool to evaluate the growing number of debt issues.

Credit ratings are firstly important for issuers. This is important for them because a rating most certainly will influence the costs of the capital (the interest rates they will have to pay for the capital raised). A good rating will improve also the marketability of their product.

Secondly, investors such as insurance companies, pension funds but also mutual funds, are substantial users of credit ratings. They have to know what kind of risk, what level of risk they are assuming. Besides that they can also use these ratings next to their own internal credit assessments and investment analyses in order to make proper and well informed investment decisions.

Thirdly, also a credit institution can be interested in a rating because they are entitled to use ratings for the calculation of their capital requirements according to the financial regulation actually in force. Broker-dealers also make use of credit ratings. They rely on ratings themselves when they act as issuers of debt, but also use and rely on ratings when they assist issuers in finding an appropriate rating agency or just only for selling purposes. Credit ratings reduce uncertainty for these parties. Alongside with the importance for these actors, ratings are also important for regulatory use and are often used in private contracts.

The European Commission described two general reasons why credit ratings are of great importance at least for the European market. One of them is the regulatory tool, the other one is reduction of the information asymmetry. Beyond that , rating agencies provide for the mitigation of the information asymmetry and also offer a tool for solving principal-agent and collective action problems.

Credit Rating Agencies (CRAs) exist since the 19th century, but they made their path undisturbed and without the attention of regulators and legal doctrine, despite the increasing importance they have had in financial markets development during the 20th century. The first detailed regulatory intervention has occurred in the early years of the 21st century following the corporate scandals that upset financial market, hereafter leading to default of famous companies. The CRAs then showed not to be able to predict those defaults and so to fail his main task.

The role of CRAs getting worse the financial crisis, has become startlingly clear in the subprime financial meltdown, and yet investors and the financial press still discuss ratings widely.

Business and conflicts of interest have led to an inflation of ratings and a deterioration in their quality. Thus, it would appear that CRAs need strict supervision. While certainly burdensome and likely to raise barriers of entry, the European regulation seems to be the most sensible solution. Market discipline based on competition and transparency as envisioned in the US lead to a weak surveillance regime, while leaving the regulatory license intact.

In the US the effect of this loss of reliability in CRAs ratings resulted in a new regulation based on the Credit Rating Agencies Reform Act of 2006 and the Securities Exchange Commission (SEC). Almost in the same period also Basel II Accord was issued, which fixed some basic rules about Banks' capital requirements, including many provisions concerning CRAs that attributed them a crucial role in the evaluation of banks assets and then in the determination of the capital requirement itself. Moreover, Basel II Accord and its implementation by the Capital Requirement Directive, has introduced for the first time within European Union, a core of rules concerning rating agencies. The purpose of this paper is to provide an overview on how CRAs are currently regulated under EU law, and to emphasize how, regardless of national systems or legal traditions, such regulations tend to show the same weakness and to raise the same issues. In fact, all of the examined sets of rules seem on one side to create a very profitable market for the CRAs, but on the other side to favour through certain appointment requirements the agencies who already own big shares of the rating market, avoiding then to promote an actual competition. Finally, we briefly examine the rules that have recently been proposed both in US and EU in response to the current financial crisis, in order to spotlight their most prominent innovations and to attempt to trace the ongoing trends in rating market regulation.

1 CREDIT AGENCIES AND CREDIT RATING AGENCIES

What are the Credit Rating Agencies? A possible answer comes from the official definitions given by the most important legal bodies. It is defined by the European legislator in *article 3.1.(b) of Regulation 1060/2009* as:

"a *legal person whose occupation includes the issuing of credit ratings on a professional basis".*[1]

With the Credit Rating Agency Reform Act of 2006, the U.S. legislator has created a slightly different definition and especially more detailed. According to American law a credit rating agency is described as:

"any person - ''(A) engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company; ''(B) employing either a quantitative or qualitative model, or both, to determine credit ratings; and ''(C) receiving fees from either issuers, investors, or other market participants, or a combination thereof"[2].

This definition is far narrower and more precise. It contains certain eligibility requirements that cannot be found in the European definition. It is broader in the sense however that it in theory could also cover any natural person where the European definition only covers a legal person.[3] This if of course not what is meant.

The International Organization of Securities Commissions (IOSCO) finally describes a credit rating agency as:

"those entities whose business is the issuance of credit ratings for the purposes of evaluating the credit risk of issuers of debt and debt-like securities."

[1] Regulation (EC) No. 1060/2009 of the European Parliament of the council of 16 September 2009, L302/9
[2] Credit Rating Agencies Reform Act of 2006, 15 USCS § 78c
[3] Committee of European Securities Regulators, *Technical advice to the* European Commission on the equivalence between the US regulatory and supervisory framework and the EU regulatory regime for credit rating agencies, CESR/10-332, 21-05- 2010, p. 56 and 57.

This definition comes relatively close to, and can be compared with the European definition. On the other hand a credit rating is defined by both the IOSCO and the European Committee of European Securities Regulators (CESR), now the European Securities and Markets Authority (ESMA), as:

"an opinion regarding the creditworthiness of an entity, a credit commitment, a debt of debt-like security or an issuer of such obligations, expressed using an established and defined ranking system. Credit ratings are not recommendations to purchase or sell any security". [4]

In its turn, the Credit Rating Agency Reform Act defines a "credit rating" as:

"an assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments"[5].

Although the definitions are not completely equal they do refer to the same activities performed by the same companies. The fact that most of the rating agencies look alike is not new, but to which extent can they be treated as other financial actors such as banks and accountancy firms? Partnoy agrees with Coffee and others that credit rating agencies belong within the classification of financial market „gatekeepers".[6]

Gatekeepers can be described as:

"*reputational intermediaries who provide verification and certification services to investors*"[7]

However does state that credit rating agencies differ from other gatekeepers for the following reasons. Rating agencies are more profitable than other gatekeepers, they face different and potentially more serious conflicts of interests and they are like no other active in structured finance activities[8]. The reason why credit rating agencies

[4] Code of Conduct Fundamentals for Credit Rating Agencies, OICV – IOSCO, December 2004, p. 3.
[5] Credit Rating Agency Reform Act, section 3.
[6] Partnoy 2006, p. 59.
[7] J.C. Coffee, *What Caused Enron?: A Capsule Social and Economic History of the 1990's,* Columbia Law and Economics Working Paper No. 214, January 2003, p. 13.
[8] Partnoy 2006, p. 62.

are different from other gatekeepers when it comes to conflicts of interests is caused by the fact that rating agencies are directly paid by the issuers that they rate, but also because the majority of revenues of credit rating agencies are derived from the fees paid by issuers. Combined with the ancillary services provided by rating agencies that cannot be developed by other gatekeepers, makes that rating agencies can be labelled as different at least with regard to conflicts of interest. Rating agencies however prefer not to be seen as gatekeepers but more as publishing. This has of course something to do with the liability discussion, where rating agencies at the moment are not subject to[9]. Behind that they do not want to be subject to more and stricter legislation in the future.

The History of Credit Rating Agency Regulation

While the financial markets were changing and structured finance grew, government regulators also played a key role in this industry. At the beginning European Regulators did not seek to regulate CRAs directly, they though rating agencies was a tool to oversee the financial markets. Since the success of a rating agency is based on its reputation, and as well reputation is based on the degree of freedom of its ratings, the idea was that the market was able to self-regulate this growing business field. This approach was denominated as “self-regulation”.

EU REGULATION

Regulation (EC) No 1060/2009

As a result, before the outbreak of the financial crisis, the regulatory setup in Europe was based mainly on self-regulation within certain supervisory “crash barriers” in the form of the IOSCO Code. The turning point for EU to take CRA regulations

[9] Partnoy 2006, p. 83.

under serious considerations was the international consensus on a need to regulate CRAs', reached by the G-20 leaders at the April 2009 summit. The European Commission rejected CESR and ESME's[10] advice for continued self-regulation, believing stronger oversight was necessary in light of the economic crisis, and that CRAs should be subject to registration in the EU. Therefore, end of 2008 the Commission adopted a proposal to regulate CRAs[11]. In its resolution of April 2009 the European Parliament approved the proposal [12] and on 7 December 2009 Regulation No 1060/2009 on CRAs entered into application[13]. This initial regulation introduced the principle of mandatory registration for CRAs operating in Europe, but it was not then clear who would supervise the CRAs[14]

Against the background of the findings of the De Larosiere group [15] in September 2009 the European Commission adopted legislative proposals aimed at strengthening macro-prudential supervision through the establishment of a European Systemic Risk Board (ESRB) and micro-prudential supervision through the setting up of a European System of Financial Supervisors (ESFS) comprising of three European supervisory authorities, namely the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and ESMA. ESMA was established 2010 in the Regulation No 1095/2010 with exclusive supervisory powers over CRAs. Therefore, the Commission presented in June 2010 a proposal for a regulation amending Regulation No 1060/2009 to adapt the regulation to the creation of ESMA[16].

[10] EUROPEAN SEC. MKT. EXPERT GROUP [ESME], *ROLE OF CREDIT RATING AGENCIES 8* (June 2008).
[11] Proposal for a Regulation of the European Parliament and of the Council on Credit Rating Agencies, supra note 14.
[12] Resolution of 23 April 2009 on the Proposal for a Regulation of the European Parliament and of the Council on Credit Rating Agencies, Eur. Parl. Doc. P6_TA(2009)0279 (2010)
[13] Council Regulation 1060/2009, of the European Parliament and of the Council of 16 September 2009 on Credit Rating Agencies, 2009 O.J. (L 302) (EC).
[14] Coffee, supra note 7, at 249.
[15] The de Larosière Group (Feb. 25, 2009), http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf. 21 Council Regulation 1095/2010, of the European Parliament and of the Council of 24 November 2010 Establishing a European Supervisory Authority (European Securities and Markets Authority), 2010 O.J. (L 331)(EU).
[16] Proposal for a Regulation of the European Parliament and of The Council Amending Regulation (EC) No 1060/2009 on Credit Rating Agencies, COM (2010) 289 final (June 2, 2010).

Following a period of consultation, Regulation No 513/2011 entered into force on 1 June 2011 entrusting ESMA with exclusive supervisory powers over CRAs registered in the EU in order to centralize and simplify their registration and supervision at European level[17]. ESMA represents today the first pan-European body with day-to-day regulatory authority over the securities markets[18].

The European supervisory framework

The European supervisory framework incorporates:

- The European Systemic Risk Board (ESRB), which monitors and assess potential threats to financial stability.
- The European Securities Markets Authority (ESMA), based in Paris.
- The European Banking Authority (EBA) based in London.
- The European Insurance and Occupational Pensions Authority (EIOPA) based in Frankfurt (ESMA, 2013b).

Before and during the financial crisis in 2007 and 2008, the European Parliament has called for a move towards more integrated European supervision in order to ensure a true level playing field for all actors at the level of the European Union and to reflect the increasing integration of financial markets in the Union. As a result, the supervisory framework was strengthened to reduce risk and severity of future financial crises.[19]

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[17] Council Regulation 513/2011, of the European Parliament and of the Council of 11 May 2011 Amending Regulation (EC) No 1060/2009 on Credit Rating Agencies, 2011 O.J. (L 145) (EU).
[18] Coffee, supra note 7, at 249.
[19] EIOPA 2013. [Internet]. https://eiopa.europa.eu/about-eiopa.

Regulation (EU) No 462/2013 of 21 May 2013

In November 2011 the Commission announced proposals to toughen that framework further and deal with outstanding weaknesses[20]. At the European level, the European Commission, the European Parliament, the Council of the EU, the European Securities Committee and the European Banking Committee pointed to the need to further strengthen the regulatory framework for CRAs[21]. These concerns relate notably to the risk of overreliance on credit ratings by financial market participants, the specifics of sovereign ratings, conflicts of interests with regard to high market concentration and to the issuer-pays model and CRAs' shareholder structure, threatening independence of CRAs and civil liability of CRAs vis- à-vis investors.

In the following, there is a critical analysis of the main weakness of the regulation 1016/2009 with an emphasis on the interplay between ESMA and CRAs[22].

- More Transparent and More Frequent Sovereign Debt Ratings[23]: Downgrading sovereign ratings has immediate consequences on the stability of financial markets but CRAs are insufficiently transparent about their reasons for attributing a particular rating to sovereign debt. Given the importance of ratings on sovereign debts, it is essential that ratings of this asset class are both timely and transparent. While the EU regulatory framework for credit ratings already contains measures on disclosure and

[20] 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 (Nov. 15, 2011); 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 (Nov. 15, 2011).

[21] *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 (Nov. 15, 2011); *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 (Nov. 15, 2011).

[22] *See generally* Press Release, European Commission, Commission Wants Better Quality Credit Ratings (Nov. 15, 2011), available at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/1355. (summarizing the goals of the proposed regulation).

[23] The rating of a State, a regional or local authority of a State or of an instrument for which the issuer of the debt or financial obligation is a State or a regional or local authority of a State. See generally GEORGES UGEUX, THE BETRAYAL OF FINANCE 200 (2011), at 193-196 (discussing the legitimacy of sovereign rating).

transparency that apply to sovereign debt ratings, further measures are needed such as access to more comprehensive information on the data and reasons underlying a rating, in order to improve the process of sovereign debt ratings in EU;

Therefore, further measures was needed such as access to more comprehensive information on the data and reasons underlying a rating, in order to improve the process of sovereign debt ratings in EU;

- investors' over-reliance on ratings: European and national laws give a quasi-institutional role to ratings. For example, the amount of capital that banks must hold is determined in some cases by the external ratings given to it. Furthermore, some investors rely excessively on the opinions of CRAs, and don't have access to enough information on the debt instruments rated or the reasons behind the credit rating which would enable them to conduct their own credit risk assessments. Measures were needed to reduce references to external ratings in legislation and to ensure investors carry out their own additional due diligence on a well-informed basis;
- conflicts of interest threaten independence of CRAs and high market concentration: this specific matter is particularly related to the issuer-pay business model. CRAs are not independent enough from the rated entity that contracts (and pays) them: e.g. as a rating agency has a financial interest in generating business from the issuer that seeks the rating, this could lead to assigning a higher rating than warranted in order to encourage the issuer to contract them again in the future. Furthermore, a small number of large CRAs dominate the market. The rating of large corporates and complex structured finance products is conducted by a few agencies that also happen to have shareholders that sometimes overlap;
- (absence of) liability of CRAs: CRAs issuing credit ratings in violation of the CRA Regulation are not always liable towards investors that suffered losses. National differences in civil liability regimes could result in credit

rating agencies or issuers shopping around, choosing jurisdictions under which civil liability is less likely.

The aim of the Regulation (EU) No 462/2013 of 21 May 2013 was to amend the latter regulation (in order to resolve the demonstrated weakness in this specific field).

Main elements of new rules embedded in CRA III:

- Two credit ratings required for rated structured finance instruments
- Requirement to consider appointing small CRAs
- Joint disclosure requirements in relation to structured finance instruments

The issuer, originator and sponsor [24] of a structured finance instrument established in the European Union will be required, jointly, to publish information in relation to:

- o the credit quality and performance of the underlying assets;
- o the structure of the securitisation transaction;
- o the cash flows; and

any collateral supporting a securitisation exposure

- Reduction of reliance on credit ratings
- Rotation in relation to re-securitisations
- European rating platform
- Sovereign ratings
- Advance notice of changes to rating methodologies

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[24] "issuer" is defined in CRA3 by reference to the definition in Article 2(1)(h) of Directive 2003/71/EC, i.e. "a legal entity which issues or proposes to issue securities". "originator" is defined in CRA3 by reference to the definition in point (41) of Article 4 of Directive 2006/48/EC, i.e. "either of the following: (a) an entity which, either itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised; or (b) an entity which purchases a third party's exposures onto its balance sheet and then securitises them".
"sponsor" is defined in CRA3 by reference to the definition in point (42) of Article 4 of Directive 2006/48/EC, i.e. "a credit institution other than an originator credit institution that establishes and manages an asset-backed commercial paper programme or other securitisation scheme that purchases exposures from third party entities".

- Liability, the latter EU Rating Regulation introducing civil liability of credit rating agencies has been one of the most controversial provisions of the amendment.
- Independence and avoidance of conflicts of interest due to shareholdings

4 US REGUATION

Regulations in the United States are based on a very long history reaching back to the beginning of the twentieth century. U.S. Regulations have been iteratively revised during this period and parts of it are used in several international frameworks. The relevant regulations in the U.S. are characterized according to the first two types of regulations as described above:

a) Regulations concerning the regulatory use of CRA. US regulation became entangled with credit ratings during the 1930s, in response to the 1929 market crash. The “Office of the Comptroller of the Currency” (OCC) released the first regulation concerning minimum capital requirements in the United States in 1931 and the Federal Reserve followed in 1935 and 1936. This was the first time an official regulator used the differentiation between investment-grade and speculative-grade rating by ruling, that bank holdings had to be rated above BBB – otherwise bonds had to be written down to market value. Several analogue regulations followed and are still valid today. The regulation was aimed to increase stability on the U.S. bond market but also had a side-effect that shaped the market of credit rating agencies till today: With the requirement of minimum rated bonds, the demand for credit ratings increased dramatically. Between the 1930s and the 1970s the use of ratings in regulation did not change significantly.
b) Regulations concerning the recognition of CRAs.
   Until 1975, any credit rating agency could be used to determine the rating of issuers or bonds, which caused several problems – among other things – in

regards to the rating quality. The SEC addressed this problem by defining the NRSRO category for national credit rating agencies (SEC, 1975).. With the introduction of this category, only credit ratings of CRAs that where "national recognized statistical rating organizations" could be used by banks to determine their specific minimum capital requirements. This regulation was criticized heavily as there was no formal criteria defined, how NRSRO recognition could be achieved. This issue was resolved not until 2006, when the Credit Rating Reform Act passed congressional approval: "The act provided the SEC with explicit legal authority to require rating agencies electing to be treated as NRSROs to register with it (thereby opening a clear path of entry for new competitors) and to comply with certain requirements"[25]. Although the law regarding NRSRO recognition was changed several times between 1975 and 2006 it created market entry barriers and a de-facto oligopoly on the credit rating market.[26]

In the wake of Enron, the 2002 Sarbanes-Oxley Act required the SEC to re-examine the "role and function of rating agencies in the operation of the securities market" and to specifically address potential barriers to entry[27]. According to the SEC, most of the 46 comments responding to the 2003 Concept Release supported continuing the NRSRO designation and expressed concern that "eliminating the NRSRO concept would be disruptive to capital markets.[28]"

Beyond this the SEC attempted to clarify the process of identifying NRSROs with a proposed definition[29]:

[25] The World Bank : *Credit Rating Agencies – No Easy Regulatory Solution*. Washington D.C.: The World Bank Group. 2009.

[26] White, L. J: The Credit Rating Industry: An Industrial Organization Analysis, *New York University*, EC-01-02, 2001.

[27] U.S. Securities and Exchange Commission, Report on the Role and Function of Credit Ratings Agencies in the Operation of the Securities Markets.2002

[28] U.S. Securities and Exchange Commission, "Proposed Rule: Definition of Nationally Recognized Statistical Rating Organization," Federal Register 70, no. 78 (2005): 21306–21323.

[29] U.S. Securities and Exchange Commission, "Proposed Rule: Definition of Nationally Recognized Statistical Rating Organization."2005.

i. issues publicly available credit ratings that are current assessments of the creditworthiness of obligors with respect to specific securities or money market instruments;

ii. is generally accepted in the financial markets as an issuer of credible and reliable ratings, including ratings for a particular industry or geographic segment, by the predominant users of securities ratings; and

iii. uses systematic procedures designed to ensure credible and reliable ratings, manage potential conflicts of interest, and prevent the misuse of non-public information, and has sufficient financial resources to ensure compliance with those procedures.

In 2005, the House considered legislation to reduce barriers to entry in the CRA market, and on September 29, 2006, President Bush signed the Credit Rating Agency Act of 2006. A primary result of the legislation was to reduce arbitrary SEC power to designate NRSROs and instead set timelines for SEC response. Under the 2006 law, any credit rating firm issuing ratings for at least three years could apply to the SEC to receive the NRSRO designation. The SEC would need to render a decision or set a timeline for evaluation within 90 days, and make a final decision within 120 days. Thereafter, the Credit Rating Agency Reform Act of 2006 (US Congress, 2006) aimed at these objectives by granting rule-making, supervisory and enforcement powers to the SEC in order to oversee the credit rating industry, which was previously unregulated. Analysing the provisions in detail, the reform sets out a number of obligations that rating agencies are required to comply. Rating agencies that wish to be recognised as NRSRO apply to the SEC, furnishing information on: 1) ratings' performance 2) procedures and methodologies to calculate ratings 3) policies to safeguard confidential information 4) organisational structure 5) code of ethics 6) conflicts of interest 7) 20 largest clients 8) and written certifications on the part of "qualified institutional buyers" stating that they have used the agency for at least 3 years.

The statute explicitly forbids the SEC from issuing rules concerning the substance and the methodologies of the ratings. In fact, the law ensured that neither the SEC nor the state could regulate credit ratings' content, procedures, or methodologies, and prohibited NRSROs from allowing conflicts of interest to impact rating integrity or "conditioning ratings . . . on an issuer's purchasing other services from the NRSRO." The SEC's rule-making powers relate to: the prevention of misuse of non-public information; the management and disclosure of conflicts of interest; and the avoidance of unfair, coercive or abusive competitive practices. The Act also mandates that each NRSRO designate a compliance officer, and that it provide a confidential financial statement to the SEC**.**

Barriers to entry alone were not solely responsible for problems in market structure. Instead, regulatory dependence on NRSRO ratings also led to distorted incentives and outcomes. As a result, policymakers have considered reducing the role of NRSRO ratings. The Dodd-Frank Act attempts to address the quality of ratings via a variety of mechanisms. The primary focus of Dodd-Frank's changes to the regulation of rating agencies is in trying to close off the agencies from conflicts of interest, real or perceived.

In fact, Dodd-Frank requires improved "internal controls" for the ratings process, separating the sales and marketing functions of the agencies from the ratings process, increasing the number of independent directors on the agencies' boards of directors, and increasing the responsibilities of the ratings agencies' boards. Many of these features mirror the expanded corporate governance requirements for auditors imposed by the Sarbanes-Oxley Act

But at the same time, Dodd-Frank allows some of the "independent" board members to be users of ratings. This ignores the fact that investors in rated securities have their own incentives to avoid downgrades. Instead of reducing conflicts of interests, Dodd-Frank may very well simply be substituting one conflict of interest for another.

Overall, the Act is a mixed bag when it comes to the credit rating agencies. Some provisions have a real potential for reform, but their success is also contingent on the same regulatory process that created the problems.

CONCLUSION

Credit rating agencies are an important part of the globalized financial system and thus influence the global economy. Following the global financial and economic crisis, and the role of CRAs therein, the legal regime applicable to credit ratings and CRAs have come under scrutiny both at the national and international levels. Credit ratings plays a fundamental role for the judgement of risk-sensitive activities, and to reduce information asymmetries and principal-agent problems in financial markets. Because ratings balance accuracy with stability, no viable alternative exists. Private CRAs are best-suited to providing independent assessments of the creditworthiness of an issuing entity. However, natural barriers of entry in the rating industry and widespread conflicts of interest have led to a deterioration in the quality of ratings. Overreliance on credit ratings, lack of due diligence and competition have been made out as major factors having contributed to the developments that put CRAs in a critical place in the crisis. Both in the United States and in the EU legislative activities were subjected to reviews. Since 2009, led by the United States, the legislative effort went in the same direction. The European Union, in fact, until the adoption of the first regulation, then improved over the following years, maintained a neutral behaviour against rating agencies, so called self-regulation approach. This change direction has led to the adoption of three new regulations in four years, going from a regime of self-regulation to over-regulation, in response to the sovereign debt crisis of 2011, arriving even to address Civil Liability to rating agencies if responsible for the damages caused to the state or the investors. Over-regulation as a populist response in times of crisis is of course anticipated. It is among the most powerful tools in a politician's array of choices. The aim of this paper is to describe the radical change of the European choice regarding the CRAs. All of this driven by the International bodies' guideline and giving a glance to the USA regulation framework and the relative updates.

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