ECO/243
Rating Agencies

Brussels, 13 May 2009

OPINION
of the
European Economic and Social Committee
on the
Credit Rating Agencies

Rapporteur: Mr Peter Morgan
On 1 December 2008 the Council decided to consult the European Economic and Social Committee, under Article 95 of the Treaty establishing the European Community, on the

Proposal for a regulation of the European Parliament and of the Council on Credit Rating Agencies

The Section for Economic and Monetary Union Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 1 April 2009. The rapporteur was Mr Morgan.

At its 453 plenary session, held on 13 – 14 May 2009 (meeting of 13 May 2009), the European Economic and Social Committee adopted the following opinion by 157 votes to 4 with 5 abstentions.

1. Conclusions and Recommendations
1.1 The context for this opinion is the worst peacetime economic crisis in eighty years. It is causing severe damage to the interests of employers, employees and all the other groups represented by the EESC as well as to civil society in general. Businesses are failing, employment is falling, homes are being repossessed, pensions are in jeopardy, civil unrest is spreading and governments are failing. A root cause of this crisis has been the performance of the unregulated Credit Rating Agencies (CRAs). The role of the CRA is central to the working of the financial system and, as such, cannot be left unsupervised. Self regulation has failed dramatically and the performance of the credit rating industry has been disgraceful. The EESC fully supports the plan to regulate and register the CRAs.

1.2 For historical reasons the business of credit rating is a global oligopoly involving three main CRAs (credit rating agencies) known as Fitch, Moody’s and S&P. Although headquartered in the USA, they are also the main providers of credit rating services in the European Union. CRAs have been subject to SEC registration in the USA since 2007. As yet there is no registration requirement in the EU. Registration is, of course, a precursor to regulation.

1.3 Beginning in 2007, delinquency and foreclosure rates for subprime mortgage loans in the USA increased dramatically, creating turmoil in the markets for residential mortgage-backed securities (“RMBS”), backed by such loans, and collateralised debt obligations (“CDOs”), linked to such securities. As the performance of these securities continued to deteriorate, the three CRAs most active in rating these instruments downgraded a significant number of their ratings. The CRA performance in rating these structured finance products raised questions about the accuracy of their credit ratings generally as well as the integrity of the ratings process as a whole.

1.4 In 2006 the European Commission set out its regulatory approach to CRAs and stated that it would monitor developments in this area very carefully. In October 2007, EU Finance Ministers agreed to a set of conclusions on the crisis which included a proposal to assess the role played by CRAs and to address any relevant deficiencies. After consulting widely and taking into account activities in other countries, the Commission has brought forward this draft Regulation.

1.5 The proposal has four overall objectives:
- first, to ensure that CRAs avoid conflicts of interest in the rating process or at least manage them adequately;
- second, to improve the quality of the methodologies used by the CRAs and the quality of their ratings;
- third, to increase transparency by setting disclosure obligations for the CRAs;
- fourth, to ensure an efficient registration and surveillance network, avoiding regulatory arbitrage between EU jurisdictions.

1.6 Since the Commission published its regulatory proposals, the Larosiere Group has published its report. In respect of the CRAs, it made the following recommendation:
- within the EU, a strengthened CESR should be in charge of registering and supervising CRAs;
- a fundamental review of CRAs' business model, its financing and of the scope for separating rating and advisory activities should be undertaken;
- the use of ratings in financial regulations should be significantly reduced over time;
- the rating for structured products should be transformed by introducing distinct codes for such products.

These recommendations are discussed in the relevant sections of the opinion.

In addition, the Group observed that “It is crucial that these regulatory changes are accompanied by increased due diligence and judgement by investors and improved supervision.” The EESC strongly endorses this observation.
1.7 COREPER has also considered the Commission’s regulatory proposals. The EESC supports the proposal for the endorsement of ratings established in third countries.

1.8 In general, the EESC supports the Commission’s proposals. The CRAs played a defining role in the development and credibility of structured products which have turned out to be toxic and have destroyed hundreds of billions of dollars worth of assets. The provisions of the proposed Regulation are the least that are called for in the circumstances. Furthermore, it is the EESC assessment that the rules will not be an undue burden for a well run CRA.

1.9 CRAs occupy a privileged position in the financial services industry because regulated entities in the industry must hold investment grade securities. On both sides of the Atlantic, the authorities have chosen to recognise very few CRAs for regulatory purposes. The EESC encourages the Commission to use the new registration process to open up the ratings business to new CRAs, notably by supporting any initiatives to create an independent European agency, and rewrite financial regulation to recognise for regulatory purposes ratings from any EU registered CRA. It will not be easy for new CRAs to become established and gain credibility. Nevertheless, the rise of Fitch in the last decade, financed by a French holding company, shows that it can be done.

1.10 Financial services regulation has been the main driver of the CRA oligopoly because of the reliance placed on ratings in respect of capital reserves. The EESC urges EU regulators not to place undue reliance on ratings, especially in the light of recent experience where certain ratings have been found to be worthless. This is consistent with the Larosiere Group recommendation that the use of ratings for financial regulation should be significantly reduced over time.

1.11 In this context, the EESC also asks the Commission to deal with the issue of CRA disclaimers. Because the disclaimers tend to render the ratings worthless, the ratings themselves are not actually a satisfactory basis for determining regulatory capital. Steps must be taken to hold CRAs responsible for their ratings. Genuine errors can be tolerated but failures of due diligence cannot.

1.12 The EESC supports the proposal that CRAs must be a legal person established in the Community and that the home Member State should be the regulator. The Commission has presented its arguments for not moving regulation and supervision to a centralised body. While this conflicts with the Larosiere Group proposal, the EESC does not necessarily reject the idea of creating a new supervisory authority at EU level should the arrangements for cooperation between Member States prove to be inadequate.

1.13 The EESC is delighted to see that the proposed regulation has real teeth. The supervisory measures available to the competent authorities include withdrawing a registration and initiation of criminal proceedings. Penalties must apply to cases of gross professional misconduct and lack of due diligence. Penalties must be effective, proportionate and dissuasive. The penalties must be applied uniformly in all Member States. The EESC believes that this should be coordinated by the Committee of European Securities Regulators (CESR).

1.14 organisationally there is considerable dependence on the role of the independent non-executive directors. The EESC believes that it should be mandatory that all non-executive appointments receive prior approval from the competent authority. In the proposed scheme of things, such approval is indispensable.

1.15 The EESC asks Member State competent authorities, as part of their organisational supervision, to watch closely the linkage between the rating business and the expectations of shareholders. The business model of a CRA cannot be readily adapted to the ethos of a public company. Particular attention should be paid to the structure of executive performance bonuses. The Larosiere Group has expressed the same concern and asked for a further examination of the CRA business model. The EESC supports this.

1.16 The EESC welcomes the provisions of Article 7. The publication of methodologies will make it evident if ratings have been arrived at by short cuts or by-passes. In addition the CRA is now bound to check its information sources and ensure that they are good enough to permit a rating to be established. Equally as important, the rules relative to determining regulatory capital. Steps must be taken to hold CRAs responsible for their ratings. Genuine errors can be tolerated but failures of due diligence cannot.

1.17 As far as disclosure is concerned, the EESC is particularly pleased that the EU will go further than the USA in respect of structured products, requiring that, in one way or another, the potentially toxic features of these products be highlighted to potential investors. The Larosiere Group has proposed that a separate notation system be used. This would be the EESC’s preferred option.

1.18 Objections to a separate series of rating symbols for structured products focus on the likelihood that after the massive downgrades which have taken place, bonds carrying this distinct notation could be regarded as lower grade investments. In the view of the EESC, that would be no bad thing until the rating reputation of such bonds is re-established.

1.19 The various general disclosures for both regulatory and market purposes are fine, with two caveats. The EESC would like the provision in the EU regulation relating to semi-annual disclosures of default rates to be quite specific and the 5% disclosure rule to be reviewed by the CESR.

1.20 Concern has been expressed on both sides of the Atlantic about the possibility that the US and EU regulatory
2. Introduction

2.1 An RMBS is created by an arranger, generally an investment bank, which packages a pool of mortgage loans – generally thousands of separate loans – into a trust. The trust issues securities collateralised by the pool. The trust uses the receipts from the securities to purchase the loan pool. The aggregate monthly interest and principal payments into the pool from the individual mortgage loans are used to make monthly interest and principal payments to RMBS investors. Three main devices are used to turn these packages of dubious subprime loans into AAA rated products: (i) the RMBS is split into tranches offering a hierarchy of security and yield, (ii) over collateralisation, so that the value of the pool of mortgages exceeds the value of the RMBS, (iii) excess spread so that the mortgage interest due from the pool exceeds the amount of RMBS interest to be paid. In addition, there was an underlying assumption that house prices would keep rising.

2.2 A CDO is conceptually similar except it uses debt securities, not mortgages. Usage of RMBS in CDO collateral pools increased from 43.3% in 2003 to 71.3% in 2006, effectively creating a second house of cards on top of the first. The US Securities and Exchange Commission (SEC) found a CRA internal email which referred to the CDO market as a “monster”. “Let’s hope we are all wealthy and retired before this house of cards falters”.

2.3 A key step in creating and ultimately selling a subprime RMBS or CDO is the determination of a credit rating for each tranche issued by the trust. In August 2007 the SEC initiated an examination of the CRA role in the turmoil which had occurred. The focus of the examination was the way in which the CRAs had rated RMBS and CDOs. Key areas of review included:

a) rating policies, procedure and practices including models, methodologies, assumptions, criteria and protocols;
b) adequacy of the disclosure of the above;
c) whether the CRAs were actually complying with their own procedures;
d) the efficacy of conflict of interest procedures;
e) whether ratings were unduly influenced by conflicts of interest.

2.4 The general findings were reported as follows:

a) there had been a substantial increase in the number and the complexity of RMBS and CDO deals since 2002; some of the CRAs had struggled to handle the growth, especially of CDOs, with a consequent impact on the completeness of the rating process;
b) significant aspects of the ratings process such as ratings criteria were not always disclosed; “out of model” adjustments were made without any documented rationale;
c) none of the agencies had documented procedures for rating RMBS and CDOs, nor did they have specific policies and procedures to identify or address errors in their models or methodologies;
d) the CRAs had begun to implement new practices to examine the rating information provided to them by issuers, but previously there had been no requirement for the CRA to verify the information contained in RMBS portfolios, nor did they insist that issuers perform due diligence on those portfolios;
e) the CRAs did not always document significant steps in the ratings process – including the rationale for deviations from their models and for rating committee actions and decisions – and they did not always document the presence of significant participants in rating committees;
f) the processes for surveillance of on-going ratings used by the CRAs appear to have been less robust than the processes used for initial ratings; lack of resources had impacted the timeliness of surveillance activity, the surveillance which was conducted was poorly documented and there was a lack of written procedures;
g) issues were identified with the management of conflicts of interest and their affect on the ratings process; key participants in the ratings process were allowed to participate in fee discussions;
h) internal audit processes varied significantly; only one of the three agencies was considered to have adequate compliance controls.

2.5 There is an inherent conflict in the business model of the industry because the debt issuer pays for the rating, but it is exacerbated in the case of structured products because (i) the arranger is the designer of the deal so there is flexibility in the way it can be structured to optimise ratings and the arranger can also choose the CRA which will give the issue a favourable rating and (ii) there is a high concentration of arrangers.

2.6 In a sample of 642 RMBS deals, 12 arrangers handled over 80%; in a sample of 368 CDOs, 11 arrangers accounted for 80%; 12 of the largest 13 RMBS underwriters were also the 12 largest CDO underwriters. The combination of the arrangers’ influence in determining the choice of rating agency and the high concentration of arrangers with this influence appear to have heightened the conflicts of interest inherent in the “issuer pays” compensation model.

2.7 The SEC published its findings in July 2008, having already put out regulatory proposals for consultation. New
regulations were published in the USA on 3 December 2008. The EU Commission published its draft Regulation -(COM2008) 704 final - on 12 November 2008 and it is this publication to which this Opinion refers.

2.8 Investigation has not been confined to the regulators. On 18 October 2008, the Financial Times (FT) printed an exposé of the role of Moody’s in the subprime crisis which Moody’s did not refute. Certain of the insights included in the article are given in paragraphs 2.9 to 2.12.

2.9 Moody’s went public in 2000. After the listing, the change was precipitous. There was a sudden concentration on profit. Management got stock options. The whole centre of gravity shifted. Moody’s reported the highest profit margins of any company in the S&P 500 index. It held that position for 5 years running. Its shares rose by 500% in the first four years of trading, at a time when the rest of the market was down. Moody’s earnings grew by 900% in a decade.

2.10 In the early days of the millennium it was almost impossible for a CDO to get a triple A rating from Moody’s if the collateral was entirely made up of mortgages. The agency had a long-standing “diversity” score which prevented securities with homogenous collateral from winning the highest rating. As a result Moody’s lost market share because the two competitors did not apply such a prudent rule. Moody’s withdrew the rule in 2004 after which its market share rocketed.

2.11 In 2006, Moody’s started to rate CPDOs – constant proportion debt obligations. The rating was triple A. Fitch, which was not asked to rate any CPDOs, said that its models put these bonds barely above junk grade. CPDOs were reported to be the most lucrative instrument Moody’s had ever handled. In early 2007 an error was found in the computer code for CPDO performance simulation. It turned out that the product was being over rated by as many as four grades. The error was not disclosed to investors or clients. The code was revised so that once again it delivered triple A ratings. Subsequently, after the FT revealed the error, internal disciplinary proceedings were begun.

2.12 By mid year 2007 the US housing down turn was well under way. Moody’s then realised that its models were inappropriate. It began to down grade mortgage-backed bonds in August 2007 and the turmoil had begun. In the final few months of the year, Moody’s downgraded more bonds than it had over the previous 19 years combined. Moody’s insists that there was no way that it could have foreseen the onset of the credit crisis, but Moody’s had not updated its basic statistical assumptions about the US mortgage market since 2002. Internal staff were debating the issue in 2006 but the resources were not available to do the necessary review and re-appraisal.

2.13 Factual evidence from the SEC and anecdotal evidence from the FT both show that many changes are needed if the CRAs are to fulfil the role and meet the standards expected of them.

3. Gist of the Proposed Regulation

Registration and Surveillance Framework

3.1 Article 2 states that the Regulation shall apply to credit ratings used for regulatory purposes while Article 4 states that financial institutions may only use for regulatory purposes credit ratings which are issued by CRAs established in the Community and registered in accordance with this regulation.

3.2 Article 12 states that a CRA may apply for registration in order to ensure that its credit ratings can be used for regulatory purposes provided that it is a legal person established in the Community. The competent authority of the home Member State shall register the CRA if it complies with the conditions set out in the regulation. The registration shall be valid throughout the Community.

3.3 The initial application for registration must go to the CESR (Committee of European Securities Regulators) who will forward it to the responsible home Member State(s) (Article 13), where it will be examined (Article 14) and then registered or declined by the home Member State in consultation with the CESR (article 15). There are provisions to withdraw the registration if the CRA becomes non compliant (Article 17). CRAs must make an application for registration within six months of the Regulation coming into force (Article 35).

3.4 Article 20 describes the powers of the competent authorities. They are not permitted to interfere with the content of credit ratings. However, they may:

- have access to any document in any form and receive or take a copy thereof;
- demand information from any person and if necessary to summon and question a person with a view to obtaining information;
- carry out on-site inspections with or without announcement;
- require records of telephone and data traffic.

3.5 Article 21 outlines the supervisory measures available to the competent authorities. These include withdrawing a registration, temporary prohibition on issuing ratings, suspension of the use of the CRA’s ratings, public notification of breaches of regulation and initiation of criminal proceedings.

3.6 Articles 22 to 28 detail provisions for cooperation between competent authorities so that registration and supervision are effective throughout the internal market. Articles 29 and 30 provide for cooperation with third countries.

3.7 Article 31 concerns penalties to be imposed by competent authorities. It stipulates that, as a minimum, penalties must
apply to cases of gross professional misconduct and lack of due diligence. Penalties must be effective, proportionate and dissuasive.

Independence and Avoidance of Conflicts of Interest

3.8 Article 5.1 stipulates that a CRA shall ensure that the issuance of a credit rating is not affected by any existing or potential conflict of interest. Sections A (organisational requirements) and B (operational requirements) of Annex 1 of the Regulation mandate significant checks and balances.

3.9 Organisationally, responsibility rests with the main or supervisory board. The senior management shall be of good repute. There must be at least three NEDs (independent non-executive directors). Their compensation is unrelated to the performance of the business. Their term of office must be fixed and must not extend beyond five years. The appointment is not renewable and there are limitations on their dismissal within the term. All board members must have relevant experience and at least one NED must have an in depth knowledge of structured securities markets.

3.10 The NEDs must be specifically responsible for overseeing the credit rating policy and process and the avoidance of conflicts of interest. Policies and procedures must conform with the Regulation. NEDs must present opinions on these matters periodically to the board and to the competent authority as requested. For the NEDs to work effectively the rating systems must be properly established, supported by internal controls and subject to independent review.

3.11 Operationally, the CRA shall identify and eliminate or, where appropriate, manage and disclose any actual or potential conflicts of interest. Both personal and corporate conflicts are spelled out. For example, a CRA shall not provide consultancy or advisory services to the rated entity or any related third party regarding the corporate or legal structure, assets or liabilities of the rated entity or any related third parties. Similarly, a CRA shall ensure that analysts do not make proposals or recommendations, either formally or informally, regarding the design of structured finance instruments on which the CRA is expected to issue a rating.

3.12 A CRA shall keep records and audit trails of all its activities including its commercial and technical dealings with rated entities. Such records should be retained and made available to the competent authority upon request.

Employees

3.13 Article 6 requires that employees involved in rating should have appropriate knowledge and experience, should not be involved in commercial negotiations with rated entities, should not work with any entity for less than two years or more than four and should not have their compensation linked to revenues earned from the rated entities for which they are responsible.

3.14 Appendix 1, section C, spells out more rules relating to employees. These prohibit the analyst or related parties from owning or trading in the financial instruments of any entity for which he or she is responsible or soliciting gifts or favours from that entity. Other provisions relate to confidentiality and the security of information.

3.15 Two provisions related to the subsequent employment of an analyst by an entity for which he or she had worked on the rating. There is also the provision that when an analyst moves to a rated entity, the relevant work of the analyst over the previous two years should be reviewed.

Rating Methodologies

3.16 Article 7 requires the CRA to disclose to the public the methodologies, models and key rating assumptions it uses. It shall adopt all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from reliable sources.

3.17 A CRA shall monitor credit ratings and review its credit ratings where necessary. When rating methodologies, models or key rating assumptions are changed, a CRA shall take immediate action to communicate the likely effect, review the affected ratings and re-rate accordingly.

Disclosure and presentation of Credit Ratings

3.18 Article 8 stipulates that a CRA shall disclose any credit rating, as well as any decision to discontinue a credit rating on a non-selective basis and in a timely manner.

3.19 Section D of Annex 1 requires the CRA to disclose:

- whether the rating was disclosed to the rated entity before dissemination and, if so, whether it was amended following this disclosure;
- the principle methodology(ies) used to determine the rating;
- the meaning of each rating category;
- the date the rating was first released and the date it was last updated.

The CRA should also state clearly any relevant attributes or limitations of the rating, especially with regard to the quality of the available information and its verification.
3.20 In a case where the lack of reliable data or the complexity of the structure of a new instrument or the quality of the information available is not satisfactory or raises serious questions as to whether a CRA can provide a credible credit rating, the CRA should refrain from issuing a credit rating or withdraw an existing rating.

3.21 When announcing a credit rating, the CRA should explain the key elements involved. In particular, when a structured finance instrument is rated, it shall provide information about the loss and cash flow analysis it has performed.

3.22 Also, for structured finance instruments, the CRA must explain its assessment of the due diligence carried out on the underlying assets (such as a book of sub prime mortgages). If it has relied on a third party assessment, it should disclose how the outcome of that assessment has affected the rating.

3.23 Article 8 also deals with the concern that ratings for structured finance instruments are not comparable with ratings for conventional debt instruments. Accordingly, CRAs must either adopt different symbols, abandoning the familiar alphabet or, alternatively, attach a detailed explanation of the different rating methodology for these instruments and the way in which the risk profile differs from conventional instruments.

**General and Periodic Disclosures**

3.24 The disclosures called for in Articles 9 and 10 are detailed in Annex 1, section E. The general disclosures are required to be publicly available and up to date at all times. The specifics relate to the most important regulatory elements such as conflicts of interest, disclosure policy, compensation arrangements, rating methodologies, models and key assumptions, changes to policies and procedures, etc.

3.25 The periodic disclosures include default rate data on a six monthly basis and client data on an annual basis.

3.26 In addition, an annual Transparency report is required. This will include details of CRA legal structure and ownership, a description of the internal quality control system, statistics on staff allocation, details of the record keeping policy, outcome of the annual internal review of independence compliance, a description of the staff rotation policy between clients, information about sources of revenue and a governance statement.

4. **EESC Perspective**

4.1 CRAs occupy a privileged position in the financial services industry because regulated entities in the industry must hold investment grade securities. On both sides of the Atlantic, the authorities have chosen to recognise very few CRAs for regulatory purposes. The EESC encourages the Commission to use the new registration process to open up the ratings business to new CRAs, notably by supporting any initiatives to create an independent European agency, and rewrite financial regulation to recognise for regulatory purposes ratings from any EU registered CRA.

4.2 Financial services regulation has been the main driver of the CRA oligopoly because of the regulatory reliance placed on ratings in respect of capital reserves. The EESC urges EU regulators not to place undue reliance on ratings, especially in the light of recent experience where the ratings have been found to be worthless.

4.3 In addition, the EESC asks the Commission to deal with the issue of CRA disclaimers. These typically state that “any user of the information contained herein should not rely on any credit rating or any other opinion contained herein, in making an investment decision”. To argue that ratings are just an opinion and not to be relied on makes a mockery of the concept of regulatory capital, as has been demonstrated by the current crisis. The new regulation should include the requirement that CRAs stand behind their ratings.

4.4 The EESC also supports the proposal that CRAs must be a legal person established in the community and that the home Member State should be the regulator. However, the EESC does not necessarily reject the idea of creating a new supervisory authority at EU level should the arrangements for cooperation between Member States prove to be inadequate.

4.5 The EESC is delighted to see that the proposed regulation has real teeth as spelled out in Articles 21 and 31. (paragraphs 3.5 and 3.7 above). The lack of such sanctions has been a major criticism of the comparable US regulations. It is important that penalties are applied with the same vigour in all Member States. The EESC believes that this should be coordinated by the CESR.

4.6 The proposed organisational and operational regulations are well conceived. The requirement that three independent non-executive directors be appointed is in line with the code of corporate governance adopted in the UK and elsewhere. There will be considerable dependence on the role of the independent non-executive directors. Their conduct and performance will determine the success of the organisational rules. The EESC believes that it should be mandatory that all non-executive appointments receive prior approval from the competent authority. In the proposed scheme of things, such approval is indispensable.

4.7 Fitch is 80% owned by Fimalac SA which is itself 73% owned by Marc de Lacharriere. S&P is part of the McGraw Hill group of companies. Until 2000 Moody’s was part of the Dun and Bradstreet group. The evidence of the FT investigation suggests that after 2000, Moody’s historic professionalism may have compromised by stock market imperatives. The EESC asks Member State competent authorities, as part of their organisational supervision, to watch closely the linkage between the rating business and the expectations of shareholders. Particular attention should be paid to the structure of executive reward packages.

4.8 Operationally, the prohibitions detailed in paragraph 3.11 above are central to controlling and avoiding the most important element in the conflicts of interest which have been detected. A CRA may no longer rate a deal on which it
4.9 The rules regarding employees are also designed to eliminate conflicts of interest. As is the case with external auditors, there are limits to the length of time that an analyst can be associated with any one client, although the four year limit might be relaxed to five. As is the also the case with auditors and all branches of the financial services industry, analysts may not have an interest in the stocks and shares of a client. The EESC is pleased that these prudential rules will now be respected by CRAs.

4.10 The EESC is very supportive of the provisions of Article 7. It will address the very evident abuses found by the SEC investigation. The publication of methodologies will make it evident if ratings have been arrived at by short cuts or by-passes. In addition the CRA is now bound to check its information sources and ensure that they are good enough to permit a rating to be established. Equally as important, the rules relative to changing methodologies and assumptions, had they been in force, could have highlighted the rating errors years earlier than 2007. The EESC proposes that compliance with Article 7 should be closely monitored and, if necessary, its provisions could be strengthened.

4.11 Article 8 closes the loop by requiring disclosure of the way in which the CRA has applied to each deal the rules detailed in Article 7. The EESC is particularly pleased that the EU will go further than the USA in respect of structured products, requiring that, in one way or another, the potentially toxic features of these products be highlighted.

4.12 Objections to a separate series of symbols focus on the likelihood that after the massive downgrades which have taken place, bonds carrying this distinct notation could be regarded as lower grade investments. In the view of the EESC, that would be no bad thing until the rating of such bonds is re-established.

4.13 The COREPER work has highlighted the fact that the proposed regulation does not deal specifically with ratings developed in third countries. The EESC supports the COREPER proposal that such ratings may be used for regulatory purposes in the EU when they are endorsed by a CRA already registered in the EU on condition that:

- the two agencies involved form part of the same group
- the non-EU agency abides by obligations similar to EU regulations
- there is an objective reason for the third country rating issuance
- there is established co-operation between the relevant competent authorities

4.14 The various disclosures for both regulatory purposes and to inform the market seem fine, with perhaps two caveats.

- Default rates are important because they provide a measure of the quality or otherwise of the rating activity of each CRA. In the USA the requirements are specific: that CRAs publish performance statistics for one, three and ten years in each rating category so that it will be evident how well their ratings had predicted defaults. The EESC would like the provision in the EU regulation to be quite specific on this point.
- There is also a requirement that clients representing more than 5% of turnover be identified. This limit may be too low. The EESC asks that it should be further considered by the CESR.


The President
of the
European Economic and Social Committee

Mario Sepi

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