LEGAL ANALYSES

Credit Rating Agencies—Too Big to Fail?

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Credit rating agencies; EU law; Financial regulation; United States

Introduction

In the United States and Europe credit rating agencies are widely perceived as being complicit in the global financial crisis.[1] Especially the big three US rating agencies Moody's, Standard & Poor's (S&P's) and Fitch have lost credibility in the eyes of many nations and investors. At a particularly sensitive time when the sovereign debt crisis hit Greece, and European countries went all out to prevent the crisis from spreading to other EU nations, the agencies only added fuel to the fire by repeatedly lowering their ratings of Greece's and other European nations' sovereign debt. As a result, these European nations faced a drastic increase in expenses in financing costs leading to some of them losing completely their financial ability. S&P's recent historical downgrade of US sovereign debt and the resulting turmoil in global markets show once again that the power of the rating agencies remains unbroken to this day.[2]

For these reasons, governments, organisations and legal commentators worldwide have pressed for tougher regulations for credit rating firms in an effort to ensure that ratings are not influenced by the firm's own profit-seeking and a conflict of interest due to ties with the firm's own clients.[3]

The following article discusses the recent legislative proposals of the United States and the European Union to further regulate the credit agencies. It will be demonstrated that despite an effective set of reforms to limit the power of the rating agencies, practical problems, legal loopholes and administrative obstacles remain. It is particularly doubtful whether, in the long run, investors will give up their established and sometimes legally required practices to extensively rely on the ratings of the big rating agencies.[4] Despite the latest legal proposal of the US Security and Exchange Commission (SEC) to remove many of these requirements, implementation progress has so far been slow.

It must also be borne in mind that current regulation and implementation processes in the United States and the European Union can lead to serious organisational and structural problems in the future. These range from problems in the creation of supervisory institutions, to confusion over responsibilities of different units, lack of knowledge and skills required for analysing and rating investment products, coordination and excessive centralisation. Therefore, a delicate balance must be found between legal government intervention to ensure investor protection and the free market forces which need credit ratings as an indispensible element to capital formation, investor confidence, and the efficient performance of the global economy.[5]

The rise of the rating agencies

The problem with rating agencies is not new. They have long been accused of being either too slow in reacting to market events or acting pro-cyclically, i.e. downgrading countries in bad times and upgrading them in good times.[6] Examples include their failure to correctly predict structured debt defaults or to foresee severe financial problems of sovereign issuers as the collapse in Argentina in 2001 and established corporations, such as Enron, AIG, or Lehman Brothers.[7] The three big rating agencies today rate everything from corporate debt to pension funds to

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[1] See Kate O. Suilleabhain, "Who will watch the watchmen? Rating agency liability in Securities Litigation" (2010) 20(4) *Securities Litigation Journal* 1–9; Margaret M. Blair, "Financial Innovation, Leverage, Bubbles and the Distribution of Income" (2010/ 2011) 30(1) *Review of Banking and Financial Law* 225–312; Elizabeth Devine, "The collapse of an empire? Rating agency reform in the wake of the 2007 financial crisis" (1978) 16(1) *Fordham Journal of Corporate and Financial Law* 177–202.

[2] See *http://www.ft.com/cms/s/0/16232716-c406-11e0-b302-00144feabdc0.html#axzz1VkDjyUp5* [Accessed October 18, 2011]. The Securities and Exchange Commission is, however, currently examining the model used by S&P's to downgrade US government debt, following accusations by the Treasury Department of a US $2 trillion miscalculation. The SEC's exam unit also is looking at which employees at S&P knew in advance of the decision to downgrade and who would benefit from this decision, see *http://online.wsj.com/article/SB10001424053111904823804576504631278044492.html* [Accessed October 18, 2011].

[3] See Josh Wolfson, Corinne Crawford, "Lessons from the current financial crisis; should credit rating agencies be restructured?" (July 2010) 8(7) *Journal of Business and Economics Research*; in favour of moderate regulation: Kei Kordachi and Tetsuya Kamiyama, *Regulatory changes and investment banking: seven questions*, in: Yasuyuki Fuchita, Richard J. Herring, and Robert E. Liton (eds), *After the crash: the future of finance* (Baltimore, 2010) 72–73; Tobias Johnson, "Regulating credit rating agencies: The issue of conflicts of interests in the rating of structured finance" (2010) 12(1) *Journal of Banking Regulation* 1–23.

[4] See for an actual overview on where credit rating is legally required: Patrick S. Collins, *Regulation of Securities, Markets, and Transactions, A guide to the new environment* (Hoboken, New Jersey, 2011).

[5] See William F. Johnson, "International economic freedom, banks and the market crisis of 2007–2001 (2011) 12(3) *Journal of Banking Regulation*" 195–209.

[6] G. Ferri, G. Liu, and J. Stiglitz, "The procyclical role of rating agencies: Evidence from the East Asian Crisis" (1999) 28(3) *Economic Notes* 335–355; Graciela Kaminsky and Sergio L. Schmukler, "Emerging Markets Instability: Do sovereign ratings affect country risk and stock returns?" (2002) 16(2) *World Bank Economic Review* 171–195.

[7] See for a good overview: *http://rru.worldbank.org/documents/CrisisResponse/Note8.pdf* [Accessed October 18, 2011].

countries. The ratings are used worldwide by bond issuers, government regulators and in structured finance. However, overreliance on credit ratings only increased in the 1970s, when the SEC first referenced them in a rule governing brokerage firms.[8] Instead of assessing the safety of brokers itself, the commission outsourced their labour to the ratings agencies. Other regulators followed the example, and within a few decades ratings agencies have been implicitly allowed by governments to fill a quasi-regulatory role.[9] From then on, the agencies charged the issuers of securities for their analyses. With the development of this flourishing consultancy business, their profit increased significantly, especially at the peak of the credit boom. In the last quarter of 2006, Moody's structured finance generated US $275.6 million of revenue, half of Moody's total from ratings compared to the most recent quarter, when structured finance accounted for only 22.7 per cent of ratings revenue.[10] However, the rating business has not become less lucrative in times of worldwide debt crises. Ironically, precisely due to the surge of corporate debt issuance, Moody's posted a 37 per cent rise in first-quarter profit 2011 to US $577.1 million from US $476.6 million a year earlier, once again topping Wall Street's expectations.[11]

The main points of criticism

Conflict of interest

One of the main points the agencies are criticised for is their business model.[12] Conflicts of interests arise because the agencies are paid to issue their ratings by precisely those companies whose securities they rate, namely, the issuers of bonds and financial products. Those companies, in turn, need to achieve high financial strength ratings in order to attract investors who provide them with more capital. Therefore, some say that rating agencies must be encouraged to make their money from investor subscriptions rather than fees from issuers, to ensure more impartial ratings.[13]

Rating shopping

Another side effect of the above described conflict of interest is a practice called rating shopping. Rating shopping is as a practice in which investment banks chose the credit rating agency offering the highest rating for a proposed transaction. This weakens the rating standard as each rating agency seeks to provide the most favourable rating to win the business rating shopping.[14]

Oligopolists

The big three agencies, Moody's, S&P's and Fitch are also accused by many of being oligopolists who control up to 95 per cent of the rating business.[15] Due to their market dominance and their assumed powers to predict and interpret future performances of companies and countries correctly, they have also been called the "Oracles at Delphi" for financial markets.[16] There are a few smaller and middle-sized rating agencies who have established themselves successfully in niche markets, however, most of them have not gained international reputation and significance yet. Competition is also being severely hampered by the fact that rating agency business is itself reputation based and barriers to market entry are high.[17]

Inaccurate models

Finally, many criticised the credit rating agencies for using flawed methodology and models. Key problems included inadequate performance data for the higher risk mortgages. The companies particularly failed to provide their employees with clear, consistent and comprehensive criteria to evaluate complex structured finance deals.[18]

New reforms in the United States and Europe in the light of international regulations

In 2006, both, the US Government and the EU institutions therefore started to reform their legal instruments to limit the power of the agencies.[19] While no consensus has formed around a single set of reforms so far, the measures

[8] Herwig Langohr and Patrizia Langohr, *The rating agencies and their credit ratings: what they are, how they work and why they are relevant* (Chichester/West Sussex, 2008) 375.
[9] Timothy J. Sinclair, "The Infrastructure of Global Governance: Quasi-regulatory mechanisms and the new global finance" (2001) 7 *Global Governance* 444.
[10] See *http://www.reuters.com/article/2011/04/27/us-moodys-idUSTRE73Q8OR20110427* [Accessed October 18, 2011]
[11] See *http://online.wsj.com/article/BT-CO-20110427-712450.html* [Accessed October 18, 2011].
[12] See Josh Wolfson, Corinne Crawford, "Lessons from the current financial crisis; should credit rating agencies be restructured?" (2010) 8(7) *Journal of Business and Economic Research* 85–90.
[13] See Carol Frost, "Credit Rating Agencies in Capital Markets: a review of research evidence on selected criticisms of the agencies" (2007) *Journal of Accounting, Auditing and Finance* 22, 469–492.
[14] See *http://www.whatthefolly.com/wp-content/uploads/2011/04/Levin-Coburn-Senate-Financial-Crisis-Report-credit-rating-agencies-pg-243-317.pdf* [Accessed October 18, 2011].
[15] Herwig Langohr and Patrizia Langohr, *The rating agencies and their credit ratings: what they are, how they work and why they are relevant* (Chichester, 2008) 386.
[16] Ann Rutledge and Sylvain Raines, *Elements of structured finance* (New York: Oxford University Press, 2010) 325.
[17] Other, smaller competitors have at least demonstrated that alternative business models exist. Some of these agencies are only paid by investors. Other agencies like, e.g Rapid Ratings prefer to rely only on their computer programs rather than on the analyses of their employees. The success rate of these agencies is high, they even predicted the problems at Bear Stearns, Citigroup and Merrill Lynch well in advance of the crisis. See *http://www.spiegel.de/international/business/0,1518,623197-2,00.html* [Accessed October 18, 2011] for further information.
[18] Frank Packer and Nikola Tarashev, "Rating methodologies for banks" (2011) *BIS Quarterly Review* 45.
[19] In the US, a Credit Rating Agency Reform Act 2006 was signed into law on September 26, 2006, under President George W. Bush while the European Commission first set out its regulatory approach to credit rating agencies in a Communication from the Commission on Credit Rating Agencies, which lead to the Proposal for a regulation on credit rating agencies in 2008. See for the proposal of the EU Commission: *http://ec.europa.eu/internal_market/securities/docs/agencies/proposal_en.pdf* [Accessed October 18, 2011].

are similar in that they are aimed primarily at introducing direct government oversight to replace self-regulation, improving the accuracy of ratings and the integrity of the rating process, particularly for structured finance.[20]

The most recent proposals, on the other hand, are supposed to amend and tighten the already existing rules. There has also been some action on promoting competition in the credit rating industry and revising the issuer-pays model, liability and establish a supervising authority. The US Government and the EU institutions have cooperated so closely that it is not surprising that a very large number of the proposals of the EU institutions are identical with those put forward by the US Government or tend in the same direction. The proposals must be seen in the light of the international regulations regarding credit rating agencies following the initiatives of the International Organisation of Securities Commission (IOSCO). With the growing need for international financial regulatory coordination, IOSCO published a Code of Conduct for Credit Rating Agencies (CRAs) in 2004 followed by a revised Code of Conduct in 2008.[21] The Code is intended to increase the quality and integrity of the rating process, to avoid conflicts of interest and to increase transparency. The CRAs may apply the code on a voluntary basis, however, compliance is subject to ongoing review by the IOSCO. A recent report about the implementation of the revised Code indicated that while the Code had been adopted by the major CRAs, two thirds of the CRAs had not implemented the provisions at all.[22]IOSCO's Supervisory task Force is therefore developing further principles to enhance cross border co-operation by regulators of CRAs with cross border activities. [23]

United States

Implementation of the Dodd-Frank Act

As a reaction to the financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law in July 2010.[24] The Subtitle C of Title IX of Dodd-Frank—"Improvements to the Regulation of Credit Rating Agencies" (Subtitle C)—established an almost wholly new framework for governing and regulating credit rating agencies, including nationally recognised statistical rating organisations (NRSROs).[25] According to § 931 of the Act, Subtitle C aims to reduce investor reliance on credit ratings and enhance competitive forces to support diligence and accuracy.[26] However, the broadly drafted Dodd-Frank Act only provides the framework for the SEC which must ultimately give effect to provisions.

Subtitle C gives the SEC an increased rulemaking authority and establishes an Office of Credit Ratings (the OCR) within the SEC. The SEC rulemaking usually involves several steps: concept release, rule proposal, and rule adoption.

The following section reviews the major Dodd-Frank Act rules regarding credit rating agencies and their current stage of the implementation[27]:

§ 922 "Whistle-blower" protection

The Dodd-Frank Act established a whistle-blower incentive program requiring the SEC to provide monetary awards to whistle-blowers who come forward with information about the violation of federal securities laws, including violations of the Foreign Corrupt Practices Act (FCPA). The Act also prohibits employers from retaliating against those who provide information about securities violations

Implementation stage

On May 25, 2011 the SEC adopted rules to create a whistle-blower program that rewards individuals who provide the agency with high-quality tips that lead to successful enforcement actions.[28]

§932 NRSRO Governance

Subtitle C contains many provisions aimed at minimising the impact of conflicts of interest on the integrity of NRSRO's issuance of credit ratings.

Implementation stage

Proposed rules regarding NRSRO reports of internal control over the ratings process (May 18, 2011).[29]

[20] See the report of the Worldbank on the regulation of credit rating agencies from October 2009 which can be retrieved from *http://rru.worldbank.org/documents/CrisisResponse/Note8.pdf* [Accessed October 18, 2011].

[21] See Technical Comm., Int'l Org of Sec Comm'ns, *Code of Conduct Fundamentals for Credit Rating Agencies* (2004), available at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD180.pdf* [Accessed October 18, 2011]; and for the *Revised Code of Conduct Fundamentals* (2008) at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf* [Accessed October 18, 2011].

[22] See Kristina St Charles, "Regulatory Imperialism: The worldwide Export of European Regulatory Principles on Credit Rating Agencies" (2010) 19 Minn. J. Int'l L. 399, 411.

[23] See IOSCO press release update on credit rating agencies update, available at *http://www.iosco.org/news/pdf/IOSCONEWS138.pdf* [Accessed October 18, 2011].

[24] See Pub.L. 111-203, H.R. 4173 ; see for a recent analysis of the Dodd-Frank-Act: Edward I. Altman, T. Sabri Oencue, Matthew Richardson, Stijn van Nieuwerburgh, and Lawrence J. White, *Regulation of Rating Agencies in: Regulating Wall Street, The Dodd-Frank Act and the new architecture of global finance*, Viral V. Acharya, Thomas F. Cooley, Matthew Richardson, and Ingo Walter (eds) (New Jersey, 2011) 443–468.

[25] To reduce dependency on credit ratings, the Act also amends certain statutes including the Federal Deposit Insurance Act, the Exchange Act and the 1940 Act to remove references to specific rating requirements and insert instead standards of credit worthiness to be established by the SEC.

[26] See Findings of the Dodd-Frank Act § 931.

[27] A list with the overall accomplishments of the SEC in implementing Dodd-Frank Wall Street Reform and Consumer Protection Act can be retrieved under *http://www.sec.gov/spotlight/dodd-frank/accomplishments.shtml#credit* [Accessed October 18, 2011].

[28] See *http://www.sec.gov/rules/final/2011/34-64545.pdf* [Accessed October 18, 2011].

[29] See for a detailed analysis *http://www.alston.com/files/Publication/4c31f83b-eac1-412d-aeea-095abae2cd55/Presentation/PublicationAttachment/d58932ff-77f1-4289-9b74-09e47740229e/CreditRatings.pdf* [Accessed October 18, 2011].

Implemented Employment Transition Report System

For NRSROs to electronically submit and for the Commission to make publicly available on the Commission's website.[30]

§ 932 Public Disclosure

Under the terms of Subtitle C, NRSROs are required to disclose an array of new information, such as the performance record of their credit ratings and the procedures and methodologies used in the credit ratings process.

Implementation stage

Proposed rules requiring certain steps be followed when adopting or revising credit ratings procedures and methodologies providing for disclosure of certain information to accompany the publication of a rating (May 18, 2011).

§ 932 Fines and penalties

The Dodd-Frank Act permits the imposition of civil money penalties in addition to cease and desist orders. Additionally, for cease and desist proceedings instituted under the Securities Act, the Dodd-Frank Act adopts the three-tiered penalty grid already contained in the Securities Exchange Act, but raises the penalty amounts by 50 per cent.

Implementation stage

Proposed rules establishing fines and other penalties for certain violations of law (May 18, 2011).

§ 932 Structure of rating agencies

Each NRSRO is required to have a board of directors, at least half of whom are independent. The board is charged with overseeing the implementation of internal controls regarding policies and procedures for determining ratings, as well as compensation and promotions within the organisation.

Implementation stage

Proposed rule amendment according to which the NRSRO would be required to file a report with the SEC containing a description of management's responsibility in establishing the internal control structure and an assessment of the effectiveness of those internal controls (May 18, 2011).

§ 933 Liability Provisions

By lowering pleading requirements, removing safe-harbour protections, and imposing filing and other requirements, Subtitle C strengthens the liability that NRSROs face.[31]

Implementation stage

Tabled

§ 936 Analyst training and testing

There are new rules regarding the qualifications, knowledge, experience and training of persons who perform ratings.

Implementation stage

Proposed rules establishing training, experience and competence standards and a testing program for NRSRO analysts (May 18, 2011).

§ 938 Consistent application of rating symbols and definitions

Rules defining the meaning of rating symbols and requiring that they be used consistently. The NRSRO is required to use distinct symbols to denote credit ratings for different types of instruments.

Implementation stage

Proposed rules regarding ratings symbols (May 18, 2011).

§ 939A Elimination of credit agency exemptions from Reg FD

Eliminates credit rating agency exemptions from Reg FD (Regulation Fair Disclosure) which mandates that publicly traded companies must disclose material information to all investors at the same time.

Implementation stage

On July 26, 2011 the SEC adopted rules to remove credit ratings as eligibility criteria for companies seeking to use "short form" registration when registering securities for public sale.[32]

[30] See *http://www.sec.gov/divisions/marketreg/nrsro_etr.htm certain employment transition reports* [Accessed October 18, 2011].

[31] This increase in potential liability has already had an effect on the three major credit agencies: In response to the repeal of r.436 (g) of the Securities Act of 1933 which established a safe harbour for certain rating agencies, the agencies refused to consent to the inclusion of the required rating information for certain asset backed securities (items 1103 (9) and 1120 of AB). This, in essence, froze some issuance of new bonds. The SEC temporarily addressed this problem by issuing a "no-action" letter that grants a six month exemption from the rating requirement for bond sales. The initial request from Ford Motor Credit Company LLC for an exemption can be retrieved from *http://www.sec.gov/divisions/corpfin/cf-noaction/2010/ford072210-1120-incoming.pdf* [Accessed October 18, 2011]. The letter from the SEC from November, 23, 2010 is available at: *http://www.sec.gov/divisions/corpfin/cf-noaction/2010/ford072210-1120.htm* [Accessed October 18, 2011].

[32] See *http://www.sec.gov/news/press/2011/2011-155.htm* [Accessed October 18, 2011].

The so called "Franken Amendment" to the Dodd Frank Act could impose further regulations on credit agencies.[33] A government entity would create an oversight board run by the SEC called the Credit Rating Agency Review Board. According to the Act the SEC would also have the authority to select the rating organisation for each investment instrument.

Implementation stage

The SEC is still in the process of evaluating the proposed Franken Amendment. The SEC has the discretion to implement an alternative system if it believes it would better serve the public interest and protect investors, but must do so before July 10, 2012 or the Franken amendment will be implemented as proposed.

Effect

While many proposals and implementations of the SEC are in theory well designed for enhancing competition and transparency within the business field of credit rating, the practical implementation process turns out to be a rocky path and the end is not yet in sight.[34] The SEC has created a special part of its website just to list elements of Dodd-Frank that were deferred due to budget uncertainty and are currently being reviewed.[35] Staffing the new office to oversee credit rating agencies belongs to those processes. The SEC also has indefinitely tabled the implementation of a regulation that would hold credit agencies liable for their ratings, a provision that is a core concern of investors. Finally, the SEC is failing to meet many of the implementation deadlines set by the Congress.[36] The ultimate effectiveness of proposals will, however, strongly depend on a rapid and precise implementation of the proposals.[37]

European Union

The Credit Rating Agencies (Amendment) Regulations 2011[38]

Purpose of the instrument

The latest Regulation 513/2011 (CRA2)[39] amends Regulation 1060/2009 (CRA1)[40] for the purpose of transferring responsibility for regulating credit rating agencies from national authorities to a new European agency, the European Securities and Markets Agency (ESMA) and was entered into force on June 1, 2011.[41] These Regulations revoke provisions of domestic law that are inconsistent or no longer required. They also make new provision in relation to ESMA's information-gathering powers and the enforcement of sanctions and penalties.

New European supervisory authority—ESMA

Under the proposed changes, the new European supervisory authority—the European Securities and Markets Authority (ESMA) is entrusted with exclusive supervision powers over CRAs registered in the European Union. This includes also the European subsidiaries of well-known CRAs such as Fitch, Moody's and Standard & Poor's.[42]

It has powers to request information, to launch investigations, and to perform on-site inspections. Issuers of structured finance instruments such as credit institutions, banks and investment firms will also have to provide all other interested CRAs with access to the information they give to their own CRA, in order to enable them to issue unsolicited ratings.

These changes mean that CRAs would operate in a much simpler supervisory environment than the existing varied national environments and would have easier access to the information they need. Users of ratings would also be better protected as a result of centralised EU supervision of all CRAs and increased competition among CRAs. Also, the provisions about disclosure are more far-reaching than those required by the Dodd-Frank-Act.[43]

In another non-legislative resolution voted at the Parliaments Plenary Session, Members of the European Parliament proposed the creation of a European Rating

[33] On May 12, 2010, Senator Al Franken (D-MN) proposed further reforms to the Dodd-Frank Act. The text of the Amendment 3991 "instruct[ing] the Securities and Exchange Commission to establish a self-regulatory organization to assign credit rating agencies to provide initial credit ratings" is available through the Library of Congress at *http://thomas.loc.gov/cgi-bin/bdquery/z?d111:SP3991* [Accessed October 18, 2011].

[34] George H. White, Alan PW Konevsky, Jessica King, The global reach of the Dodd-Frank Act, (2010) 10 *Journal of International Banking and Financial Law* 579–582.

[35] See *http://www.sec.gov/spotlight/dodd-frank/dates_to_be_determined.shtml* [Accessed October 18, 2011].

[36] See *http://www.propublica.org/article/from-dodd-frank-to-dud/single* [Accessed October 18, 2011].

[37] See Mark W. Nichols, Jill M. Hendrickson, Kevin Griffith, Was the financial crisis the result of ineffective policy and too much regulation? An empirical investigation (2011) 12(3) *Journal of Banking Regulation* 236–251.

[38] The Credit Rating Agencies (Amendment) Regulations 2011 (SI 2011/1435).

[39] Regulation 513/2011 on credit rating agencies [2011] OJ L145/30.

[40] Regulation 1060/2009 on credit rating agencies [2009] OJ L302/1.

[41] The text of the regulation can be retrieved from *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:145:0030:0056:EN:PDF* [Accessed October 18, 2011].

[42] Interestingly, the big three rating agencies have not yet fulfilled the criteria for the application of their licences to operate within Europe. ESMA has made clear though that Europe would insist on their own guidelines to monitor the behaviour of rating agencies, see *http://www.dw-world.de/dw/article/0,,15187376,00.html* [Accessed October 18, 2011].

[43] Kristina St Charles, Regulatory Imperialism: The worldwide Export of European Regulatory Principles on Credit Rating Agencies (2010) 19 Minn. J. Int'l L. 399 , 439.

foundation which would be fully independent.[44] The resolution comes some weeks before the commission is to table legislative proposals to further regulate credit rating agencies. In order to increase competition there should be a network among European credit rating agencies, without leading to the search of more favourable ratings.

- **Rating sovereign debt**

  As their US counterpart, the EU resolution calls for more light to be shed on how CRAs arrive at their sovereign ratings and what kind of methodologies they use.

- **European Credit Rating Foundation**

  The proposal also calls for a detailed assessment of a fully independent publicly-funded European credit rating foundation to enhance competition on the rating market. This is in principle desirable, however, there is some scepticism among experts whether such an independent agency is workable.[45] The main concern of the critics is whether such an institution would be fully independent and issue more accurate and timely ratings than at present. The current overreliance on ratings issued by "the big three" could simply be replaced by a reliance on ratings issued by a public rating agency, and that would not necessarily lead to any improvement in quality. Most of the registered rating agencies will not leave their market niches and gain any European or international significance. The public recognition of the agencies will therefore alone not be sufficient to get rid of the factual oligopoly.

- **Reducing dependence**

  The resolution advocates a series of measures to reduce current dependence on a very few sourcesfor credit ratings. These include increasing the use of internal credit ratings, particularly by allowing large financial institutions to carry out their own risk assessments and boosting competition.

- **Liability and transparency**

  The resolution looks at ways to hold the agencies liable for the advice that they give. Furthermore, the accuracy of past credit rating shall be assessed through more documentation for supervisors and unannounced checks on these assessments.

Summary

Credit ratings are an indispensible element to capital formation, investor confidence, and the efficient performance of the global economy. Achieving international agreement on a stronger policy framework was the first step in global regulatory reform. The next step is full and timely implementation of the new global standards.

Despite recent legislative proposals in the United States and European Union to limit the influence credit rating agencies, the big three, Moody's, S&P's and Fitch will likely continue to play a role in assessing the creditworthiness of institutions and countries. The new regulations do not prohibit their use; they simply no longer require it as a matter of law.

Rather than creating more centralistic supervisory institutions and producing over-regulation, governments and companies should promote self- responsibility and knowledge that makes investors more independent from the judgments of the big rating agencies. The governments should also provide financial support to smaller rating agencies in order to help them enter the market and build up a reputation in the credit rating sector.

Credit rating agencies should be held liable for their faulty judgments, however, this core-piece of the international legislative frameworks has not yet been fully implemented. In order to create legal certainty it must be quickly determined if and for which failings credit rating agencies can be held liable and how such a civil liability can be introduced without creating new barriers to the market entry.

[44] The press release of the European Parliament can be retrieved from *http://www.europarl.europa.eu/en/pressroom/content/20110606IPR20812/html/Beefing-up-credit-rating-agency-rules* [Accessed October 18, 2011].
[45] See for a good summary of the main criticism *http://www.europeanvoice.com/article/imported/a-credit-rating-agency-to-save-the-eurozone-/70508.aspx* [Accessed October 18, 2011].