Insurance Europe comments on the trialoque discussions on Credit Rating Agencies (CRAs)

Our reference:	ECO-INV-12-139	Date:	16 November 2012
Referring to:	Proposal for a Regulation of the European Parliament and of the Council amending Regulation No 1060/2009 on credit rating agencies of 11 November 2011		
Related documents:	ECO-INV-12-050; ECO-INV-12-081		
Contact person:	Daniel Madejski, Policy Advisor, Taxation	E-mail:	madejski@insuranceeurope.eu
Pages:	2	Transparency Register ID no.:	33213703459-54

Insurance companies, be it for their role in the markets as institutional investors or issuers, or because of the references to credit ratings in the existing prudential legislation, have a keen interest in the policy debate on CRAs.

With this document, Insurance Europe expresses its views on three main areas of concern of the insurance sector in the context of discussions on CRAs: mandatory rotation principle, over-reliance on credit ratings and civil liability.

Mandatory rotation principle

Insurance Europe welcomes the Council's willingness to limit the scope of the mandatory rotation principle to new re-securitisations with underlying assets from the same originator. In Insurance Europe's view such an approach is adequate as it will allow to test on a limited range of products a new concept that could have important distortive effects on the functioning of the markets. Cautious is required notably since the rotation principle might have a significant impact on the quality and continuity of ratings, thereby increasing uncertainty and instability in European capital markets. In addition, the change of credit rating agency would inevitably increase the risk that knowledge about the rated entity acquired by the outgoing rating agency is lost. As a result, the incoming credit rating agency would have to make considerable efforts to acquire the knowledge necessary to carry out its work. Next, frequent rotation will increase costs for issuers as it might take considerable amount of time and resources to introduce new rating agency to its business model. Finally, there is also a risk that the mandatory rotation may push CRAs towards more short-term view from their current long-term perspective as CRAs will pay attention to the risk associated within their course of rotation.

Against this background, Insurance Europe believes that limiting the scope of rotation principle to the new re-securitisations is a step in right direction.

Insurance Europe aisbl
rue Montoyer 51, B-1000 Brussels
Tel: +32 2 547 5811 • Fax: +32 2 547 5819
www.insuranceeurope.eu

Reducing overreliance on credit rating

Insurance Europe supports the latest Cypriot Presidency compromise text regarding over-reliance on credit ratings by financial institutions. In our view, the Presidency compromise text recognises that in certain cases, the use of external ratings can be a useful complement to investors' own internal assessment.

In general, Insurance Europe supports the need to reduce the over-reliance of financial markets on CRA's ratings. It should however be recognized that in practice it would neither be feasible nor desirable to refrain from any reference to external ratings. Legislation in this area should take into account the nature, scale and complexity of insurers' assets. In this sense, we believe that an obligation for own credit risk assessments for every entity or financial instrument would not be a helpful proposal and could contradict the principle of proportionality. In particular, we are concerned that Article 5ba (Amendment 66) of the proposed CRAs regulation which aim at deleting any references to credit ratings may conflict with provisions of the Solvency II Directive Implementing Measures, concerning for instance the mechanic references to ratings inserted in the capital requirements (e.g. article 109a (1) – Use of ratings from credit rating agencies). It is worth mentioning that while the use of internal models for the calculation of Solvency Capital Requirements ("SCR") are allowed under Solvency II (subject to prior supervisory approval), the SCR can also be calculated with a standard formula. All companies not using an internal model for those purposes will apply a standardized and less complex formula. The idea of a standard formula is to allow insurers whose risk profile is lower than others to use external references to assess credit risk instead of requiring them to develop their own internal credit assessments.

Having regard to the above, Insurance Europe welcomes the Presidency compromise text which acknowledges that in some cases external ratings can be used by financial institutions, as it states that competent authorities should assess the use of contractual references to credit ratings with a view to reduce mechanistic reliance on ratings, "*in line with specific sectorial regulations"*.

Furthermore, Insurance Europe welcomes the new Article 39aa introduced in the Presidency compromise text. Article 39aa introduces a more realistic timeline, i.e. 1 January 2020, for financial institutions to develop their own internal assessments and stop relying on rating agencies.

Civil Liability

Insurance Europe supports introduction of an EU-wide civil liability against CRAs. In particular, Insurance Europe supports granting issuers a right to enforce civil liability against CRAs.

However, in our view an investor should not be able to sue CRAs and its protection should be ensured by a system of fines and penalty payments as part of the regulatory system which is already in place in the EU. Insurance Europe is concerned that an EU-wide civil liability of CRAs vis-à-vis investors might result in some unwanted consequences, including especially the following ones:

• CRAs may respond to these proposed liability provisions by being overly conservative, i.e. by lowering their ratings in order to reduce the risks in case of civil actions.

• CRAs will probably increase the prices they charge to issuers in order to reflect the expected future costs in terms of possible lawsuits they would be exposed to