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AK Position Paper

Legislative proposals of the Commission on credit rating agencies

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About us

The Federal Chamber of Labour is by law representing the interests of about 3.2 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.

The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.

Organisation and Tasks of the Austrian Federal Chamber of Labour

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

More than three quarters of the 2 million member-consultations carried out each year concern labour-, social insurance- and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 - amongst others unemployed, persons on maternity (paternity) leave, community- and military service - of the 3.2 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Herbert Tumpel
President

Werner Muhm
Director

Executive Summary

The European Commission aims at remedying problem areas relating to the activities of credit rating agencies. The concrete proposal includes the amendment of three EU Directives: Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), Directive 2011/61/EC on Alternative Investment Fund Managers (AIFM) as well as the Regulation 1060/2009/EC on credit rating agencies.

The Austrian Federal Chamber of Labour (AK) would like to provide you with an initial assessment and positioning concerning the legislative initiatives at issue. However, this shall not preclude the possibility of further more specific and supplementary statements.

The AK welcomes the efforts to improve market conditions, governance and transparency;, in particular the aim of reducing the excessive reference to ratings. Ratings and the sometimes blindfold over reliance on them contributed to the creation and aggravation of the crisis in all phases. Their first class testimony for structured products, which contained nothing but rubbish, and the majority of which they had to dongrade after entering the crisis phase, led investors, who had relied on the judgment to carelessness and released bank managers from the responsibility to carry out prudent risk assessments[1]. In the end, the taxpayers, who had not participated in the game, were and still are forced to assume liability for these irresponsible actions, because the players were allowed to act without liability and responsibility.

In our opinion, the Commission has recognised the key problems (over-reliance on external ratings; independence of credit rating agencies; publication of information on the methodologies applied by credit rating agencies; ratings of public sector bonds; comparability of ratings and charges; market structures; liability of credit rating agencies towards investors), and proposes a number of amendments, which have be welcomed. However, from our point of view, with regard to some areas, the proposals fall short of the resolution of the European Parliament, and do not go far enough in respect of some very important issues such as market concentration and the problem of the conflict of interest relating to the issuer-pays model.

It is also to be welcomed that the provisions, which shall ensure both quality und independence of ratings, are also to include the rating outlook.

In any case, the applicable provisions relating to other materials, as for example laid down in the Directive Proposal on CRD IV, where exceptions to the obligation to carry out own credit risk assessments have been provided for, would have to adjusted

[1] Compare Report of the Financial Crisis Inquiry Commission (FCIC) to the US Congress from27.1.2011 or the Report of the "High Level Group on financial supervision in EU" from 25.2.2009 ("De Larosière Report")

The AK position in detail

On the issues in detail:

On 6 Articles 5a and 5b

Article 5a lays down that credit institutions, investment firms, insurance and reinsurance undertakings, institutions for occupational retirement provisions, management and investment companies, alternative investment fund managers and central counterparties (…) shall make their own credit risk assessment and shall not solely or mechanistically rely on credit ratings for assessing the creditworthiness of an entity or financial instrument.

From our point of view, this appears to be one of the key issues. Professional investors and in particular credit institutions shall not be permitted to completely outsource the reliability relating to assessing the creditworthiness. Ratings should only be one of many variables taken into account in risk assessment and investment decision. Hence, exemptions, such as the current Commission proposal on CRD IV has provided for smaller institutions, should be deleted; instead such institutions should be able to apply simplified statistical procedures. If the institution does not have sufficient data for adequate internal rating scores, investments should be restricted within the scope of a very low lump sum exposure limit.

Apart from that, the AK would also consider it appropriate for financial intermediaries to provide their clients with the clear information that exclusively relying on ratings is not suitable to assess the risk of an issuer or a financial instrument.

Article 5 b lays down that reference to ratings in guidelines, recommendations and draft technical standards by the European Supervisory Authorities and the European Systemic Risk Board should be removed by 31 December 2013 at the latest.

This shall realize the targets of G20 and the Financial Stability Board and establish broad synchronisation with the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (DFA) in the USA. It should be examined whether it would not be possible to take further steps, such as the implementation for national authorities by way of a Directive. It should also be examined as to how the ECB and the national Central Banks can be obliged to also refrain from basing their decisions on external ratings.

On 8 Articles 6a and 6b

Article 6b, Supplementary Article relating to the dominant position:

In view of the problem in respect of high market concentration and the problems of lock-ins (possible mistrust of the market in case of changing the rating agency) and also due to possible business blindness after several assessments, this proposal by the Commission is not only very welcome in the opinion of the AK, but it is only one important approach to reviving the market. Nevertheless, it is difficult to comprehend why this rotation should only apply to corporate ratings. States too can be affected by lock-in effects, as here too the market is highly concentrated.

Apart from that, it is very disappointing that not more effective means shall be used to take action against the oligopolistic market structure. Hence, in view of the high market concentration, the BAK requests a separate Article (6c) which requires the prohibition of credit rating agencies acquiring credit rating agencies, which dominate more than 20 percent of the market.

In addition, the AK refers to the resolution of the European Parliament on reviving competition by a setting up a European rating agency foundation.

On 10 Article 8

The increased transparency provisions on the methodologies are generally welcomed.

On 11 Articles 8a and 8b

Article 8a: the increased information obligation for structured financial instruments is as welcome as the publication of information on the website of ESMA. Furthermore, the AK refers to the comments on Article 5a, according to which financial intermediaries shall be obliged to inform that the exclusive reference to ratings is not appropriate to assess the risk of an issuer or a financial instrument.

Article 8b: the obligation to double credit ratings independent of each other is welcomed.

On 12 Articles 10 (1) and 10 (2)

The explicit inclusion of outlooks is welcome because announcement effects are derived from them, which indeed result in price effects.

On 13 Article 11 (2)

In order to enable the adequate assessment of the quality of ratings ex-post as well as of their impact, the provision to make historical rating data and historical performance data available both publicly and free of charge, appears to be indispensable.

On 14 Article 11a

In view of the comments on Article 11 (2), this provision relating to the European Rating Index is expressly welcomed.

On 18 Articles 21 and 19 Art 22a

The laying down of draft regulatory technical standards by ESMA - subject to their content - is as welcome as is the review of the rating methods.

On 20 Title IIIa

Article 35a: the creation of civil liability and the reversal of the burden of proof are expressly welcomed as reasoning is almost impossible for third parties. However, the reversal of the burden of proof should also apply in respect of issuers. It has to be clarified in this context that the place of jurisdiction for investors, in particular for small investors, for whom investments are not part of their normal business, is at the seat of their place of abode. Only then it will be realistic that action is brought against credit rating agencies and that claims are successfully enforced.

Further issues:

No automatic contract clause if ratings are amended at a later date

All contract clauses should be declared invalid by law, which prompt automatic consequences (e.g. interest rate increases for borrowers, additional collateral, maturity of claims) as a result of amending the rating. The assessment of the creditworthiness represents a core function of credit institutions. Such clauses strengthen the tendency to rely on external ratings. If - rightly - the original assessment of the creditworthiness is not allowed to exclusively rely on external ratings, automatic clauses relating to subsequent amendments, which might exacerbate cliff effects, must also be prohibited.

Prohibition of obtaining credit rating agencies by credit rating agencies that dominate more than 20 percent of the market

As commented on Point 8, it is from our point of view not comprehensible that, apart from rotation, there is no intention to apply more effective means to

revive the oligopolistic market. Hence, in view of the high market concentration, the AK demands a separate Article (6c) that prohibits credit rating agencies to acquire credit rating agencies, which dominate more than 20 percent of the market.

Review of alternative payment models

The problem of the current payment model lies in the fact that ratings are expensive for investors, hence those, who are actually interested in the information, and that they are not able to deny third parties access to this information. That is why usually the issuer orders the rating, which, however, can lead to massive conflicts of interest. Hence, it is worth considering that the payment (namely a fraction of the volume) is done via an agency, which either gives the mandate to a rating agency after reviewing the quality of the rating in the past, or which allocates the rating fee to those agencies that prepare the rating with a deferred payable share in results, depending on the quality of the rating. Taking the review of such alternative payment models into consideration appears to be highly appropriate.

Should you have any further questions please do not hesitate to contact

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