EUROPEAN COURT OF AUDITORS

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Press Release

Luxembourg, 1 February 2016

Regulating credit ratings agencies: "still room for improvement", say EU Auditors

The EU watchdog set up to monitor credit ratings agencies in the wake of the 2008 financial crisis has established good foundations, but significant risks remain to be addressed, according to a new report from the European Court of Auditors.

The European Securities and Markets Authority (ESMA) was set up in 2011 to register, monitor and supervise credit ratings agencies. At the time, they were more or less unregulated in Europe, and attention was focused on their impact on financial markets. ESMA now supervises 23 credit rating agencies registered in the EU. But its rules and guidelines are not yet complete, say the auditors.

They acknowledge that ESMA has managed to reduce the average duration of the registration process, but say the process remains complex. Although credit rating methodologies should be rigorous, systematic, continuous, and subject to validation, ESMA's methods focus mainly on rigour.

The current rules of the Eurosystem credit assessment framework do not guarantee that all ESMA-registered agencies are on an equal footing, which creates a two-tier market structure and puts small agencies in an unfavourable situation.

"*Credit ratings are important for investors and participants in the equity and bond markets, in some cases even replacing investors' due diligence*." **said Mr Baudilio Tomé Muguruza, the Member of the European Court of Auditors responsible for the report**. "*But there is still room for improvement in the supervision of credit ratings agencies in the EU*."

The auditors found that, while ESMA has a well-established procedure for risk identification, the lack of a documentation trail made it hard to understand why certain risks were reprioritised. Also, the reasons why ESMA conducted only limited investigations in certain high-risk areas were not documented.

Although ESMA has laid down good foundations for its supervision approach, its rules and guidelines are not complete. Documentation and internal monitoring tools are "rather rudimentary", say the auditors, and it was not always possible to trace the ongoing supervisory work performed, or the analysis and conclusions derived from it.

The purpose of this press release is to give the main messages of the special report adopted by the European Court of Auditors.
The full report is on www.eca.europa.eu

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ESMA has a unique central repository database which provides harmonised and readily accessible information on all registered and certified ratings performance. However, the auditors expressed concern about the adequacy of the statistics disclosed and the checks carried out on data reported.

The report recommends that ESMA should:

- adequately document its assessment of the requirements on credit rating methodologies during registration
- improve the traceability of the risk identification process and follow up all high-risk areas
- continuously update its supervisory manual and supervisory handbook and establish internal guidance for the effective documentation of investigations
- implement a dedicated supervisory IT system to improve knowledge sharing and clarify task ownership
- examine all important aspects of the design and implementation of methodologies not yet covered
- examine agencies' systems for dealing with conflicts of interest, in particular relating to their analysts' trading, and test the accuracy of information received about such conflicts
- consider developing additional guidance on disclosure requirements
- monitor and improve the information content of central repository disclosures based on best practices for disclosing ratings performance
- publish all applicable legislation and relevant documents, and make its website more user-friendly.

Special Report No 22/2015 "**EU supervision of Credit Rating Agencies - well established but not yet fully effective"** is available in 23 EU languages.