In a non-technical language, the book provides an overview of the history of ratings, the role of rating agencies, the industry, the uses of ratings and the rating process. The US subprime crisis that highlighted relevant deficiencies in the rating agencies’ activities and their systemic relevance, led to an international consensus to establish public oversight and regulation of the rating business. The book explains the global initiatives undertaken by the G-20, the Financial Stability Board, and IOSCO to address those failures and the European implementation of such a consensus. It also provides an overview of the new European System of Financial Supervisors implemented as a reaction to the crisis and examines the supervisory and enforcement powers of ESMA, the new authority in charge of the registration and oversight of rating agencies. Through an in-depth analysis of the European Regulation’s requirements on governance, conflicts of interest, methodologies, disclosures, and transparency, the book provides a clear explanation of how rating agencies operate and how the identified failures have been addressed. The explanation of all these aspects is complemented with an analysis of guidance from supervisors (ESMA and EBA), IOSCO’s recommendations, and US legislation. Finally, the book discusses possible new regulatory developments in areas such as the agencies’ business model, competition, civil liability, and ratings of sovereign debt. It concludes with the authors’ support for an enhanced regulatory and oversight coordination at global level, a reduction of the existing over-reliance on ratings, and a concentration of resources on the enforcement of the current regulatory regime.
Financial Crisis: Global Regulatory Reaction

Garcia Alcubilla and Ruiz del Pozo

in Credit Rating Agencies on the Watch List: Analysis of European Regulation

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Publisher: Oxford University Press

Rating agencies were in the spotlight again as a result of the US subprime crisis that started during the summer of 2007 and that highlighted the systemic relevance of the agencies in financial markets. Deficiencies were detected in three main areas: agencies were sometimes affected by conflicts of interest, were not always vigilant on the quality of the rating methodologies, and there was lack of adequate public disclosure, specially on critical model assumptions and on the characteristics and limitations of ratings. The limited scope of competition among rating agencies contributed to accentuate those weaknesses. Consensus emerged in the international regulatory community on the need to address these failures through the establishment of public oversight and regulation of rating agencies and by diminishing the excessive reliance of investors and regulations on ratings. The chapter describes the main initiatives undertaken by global organizations as a result of such international agreement: G-20, Financial Stability Board, and IOSCO.

Future Developments

Garcia Alcubilla and Ruiz del Pozo

in Credit Rating Agencies on the Watch List: Analysis of European Regulation

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The book starts with the weaknesses of the agencies in relation to asset-backed securities’ ratings and concludes with the policy discussions around the ratings of EU sovereign bonds, prompted by the Euro debt crisis. This crisis has stirred up a wider debate on other policy issues. The chapter discusses the business models proposed as alternatives to the issuer-pays model to address conflicts of interest and enhance competition, including the creation of a public European rating agency. It also presents the pros and cons of increasing civil liability for rating agencies. The impact of sovereign downgrades on financial stability is also examined, together with the European Commission’s proposals. Finally, it concludes with the authors’ support for an enhanced regulatory
and oversight coordination at global level through IOSCO, a reduction of the existing over-reliance on ratings, and a concentration of resources on the enforcement of the current regulatory framework.