

Regaining public trust – a new European system for credit ratings

Joint declaration of the Europeans for Financial Reform

The current structure of the credit rating market is destabilising the world economy. Three credit rating agencies (CRAs) control 97% of the market and their profits rose by as much as 900% during the ten years preceding the financial crisis. Since the onset of the crisis, and in particular in the US subprime market and in the eurozone sovereign bond market, the need for changing the rating system has become apparent.

In the eurozone, the need for economic and fiscal reform is also clear. But for this to be done, States need to retain their economic and fiscal tools. Yet CRAs, despite being private, profit-led and democratically unaccountable corporations, have been able to dictate policies to democratically elected governments and restrain their room to manoeuvre. Conflicts of interest, technical errors, biased ratings and incapacity to assess the specific European context make the reform of the credit rating market an absolute necessity for Europe to recover from the crisis.

Our proposal for reforming credit rating agencies

We must take immediate regulatory measures to tackle the most urgent problems of the private credit-rating system. Next to the proper regulatory framework for registered CRAs, all rules and regulations conditioning and promoting external ratings must be reviewed.

- **Decreasing the conflict of interest:** Issuers of rated financial products choose their agency according to the probability of getting a good rating. Because CRAs rely on fees paid by those who are being rated rather than by those who use ratings, their business model is flawed with potential conflict of interest. To circumvent this, the rating models and methodology used by CRAs must be supervised and disclosed to the public. Alternatives to current payment models should also be envisaged.
- **Reducing the existing over-reliance and ascribe a more commensurate role to them:** The Eurosystem itself has unnecessarily contributed to giving CRA's a disproportionate weight in its credit assessment framework. All requirements relating to external credit assessment institutions should be changed and adjusted in such a way that diminishes the role of CRAs. References to ratings from rating agencies should be removed from all statutory and legal texts. Our intention is neither to prohibit external credit ratings, nor to prevent external ratings from being published, but **to reduce the existing over-reliance and ascribe a more commensurate role to them.**
- **Fighting market abuse:** the major three agencies are largely owned by the same shareholders. The degree of their abnormal profit – above 40% of their revenues – is evidence of their market dominance, and indicates potential market abuse that must be investigated and, if appropriate, corrected.
- **Transparency:** Credible and democratic credit rating requires the highest level of transparency. Furthermore, states, unlike companies, can never go bankrupt. The rating of states has far greater consequences than the rating of individual companies. For these reasons the rating of states and the rating of companies must rely on clearly differentiated criteria.
- **Comparing CRAs' performance: A publicly accessible register of CRAs' past performances** should be created, in order to enable regulators to assign obligatory

rating according to the CRAs' accuracy, not their market position. Systems of double-ratings can also be used to limit the influence of single CRAs.

- **Enhancing internal risk assessment:** In last forty years, governments have literally outsourced their risk assessment capacities to private CRAs. This in turns has transformed the rating of private CRAs from opinions into rulings. Public as well as private institutions must favour their own risk assessment.
- **Creating an independent counterweight to private CRAs:** In the long run, the creation of a European Independent Credit Rating Agency (EICRA) would be an important step in addressing all the flaws of the credit rating system. Fully autonomous from both the market and governments, the EICRA would reduce information asymmetry in the global market, promote transparency and accountability of the current system and generate reliable information on creditworthiness for regulatory and supervisory purposes.

Reforming the current system of credit rating is an essential part of our strategy to regulate financial markets so that finance can become a true contributor to growth and jobs. This reform of the financial sector is an integral part of a progressive and fair solution to the crisis.

Europeans for Financial Reform

Europeans for financial reform is a coalition of progressive forces, ranging from NGOs to Trade Unions, citizens, academics and progressive politicians, that have come together to spearhead a campaign for real reform in our banking and financial system. The campaign was launched on [September 21st](#) 2009, and the coalition is growing, with new members joining our campaign every day (<http://europeansforfinancialreform.org/en/user/register>).