

Clients & Friends Memo

The EU Commission Proposes Onerous Requirements for Rated Structured Finance Instruments

22 July 2010

Introduction

The EU Commission has recently proposed¹ amendments to Regulation (EC) No 1060/2009 (the “**CRA Regulation**”)² of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (“**CRAs**”), which include a proposal to require all information necessary for the CRA hired by an issuer to determine or monitor the credit rating of a structured finance instrument to be made available to non-hired CRAs.

The stated purposes of the proposal are to reinforce competition between CRAs; to help avoid possible conflicts of interest under the issuer-pays model; to enhance transparency and the quality of ratings; and to promote the issuance of unsolicited ratings³. The proposal follows closely the recent amendments to Rule 17g-5 of the Securities Exchange Act of 1934 in the U.S.⁴

The Proposed Information Requirements

The proposal is to impose an obligation on the issuer of a structured finance instrument⁵ or a

¹ See the Proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EC) No 1060/2009 on credit rating agencies dated 2 June 2010 by the EU Commission available at http://ec.europa.eu/internal_market/securities/agencies/index_en.htm.

² The CRA Regulation is available at http://ec.europa.eu/internal_market/securities/agencies/index_en.htm.

³ See the related press release of the EU Commission dated 3 June 2010, “Improving EU supervision of Credit Rating Agencies - frequently asked questions”.

⁴ See our Clients & Friends Memo titled “Recent Changes to SEC Rating Agency Reform Impose Burdensome Requirements on Structured Products Participants” dated 3 March 2010 available at http://www.cadwalader.com/assets/client_friend/030310RecentChangesSECRating.pdf.

⁵ “Structured Finance Instrument” is defined in Article 3(1)(l) of the CRA Regulation as “a financial instrument or other assets resulting from a securitisation transaction or scheme referred to in Article 4(36) of Directive 2006/48/EC”.

related third party⁶ to provide to the CRA it appoints, on a password-protected website that it shall manage, all information necessary for the CRA to initially determine or monitor a credit rating of a structured finance instrument⁷.

Where a non-hired CRA that is registered or certified according to the CRA Regulation requests access to information on the website, such non-hired CRA shall be granted access without delay provided that the following criteria (the “**Non-Hired CRA Criteria**”) are met:

- such non-hired CRA has the systems and organisational structure in place to ensure the confidentiality of such information⁸; and
- such non-hired CRA provides ratings on a yearly basis for at least 10% of the structured finance instruments for which it requests access to such information⁹.

In addition, each CRA registered pursuant to the CRA Regulation is required to:

- maintain a password-protected website that shall (i) contain a list of structured finance instruments for which it is in the process of rating, and (ii) provide a link to the password protected website on which the issuer or related third party provides the information referred to above¹⁰; and
- grant access without delay to such website to any non-hired CRA registered or certified under the CRA Regulation upon request provided that such non-hired CRA meets each of the Non-Hired CRA Criteria¹¹.

Some Concerns for Issuers and Arrangers

The scope of the information required to be included on the website to be maintained by the issuer or related third party is not clear. “*All information necessary for the CRA to initially determine or monitor a credit rating of a structured finance instrument*” is potentially very wide. In particular, the scope of the information to be provided is not limited to information provided to the CRA by the issuer or a related third party¹².

⁶ “Related third party” is defined in Article 3(1)(i) of the CRA Regulation as “*the originator, arranger, sponsor, servicer or any other party that interacts with a credit rating agency on behalf of a rated entity, including any person directly or indirectly linked to that rated entity by control*”.

⁷ See proposed Article 8a(1).

⁸ The conditions of access and terms of confidentiality applicable to the website will be specified through implementing regulations. See proposed Article 8a(3).

⁹ See proposed Article 8a(2).

¹⁰ See proposed Article 8b(1).

¹¹ See proposed Article 8b(2).

¹² By contrast, in the U.S. under Rule 17g-5 the information to be posted on the issuer’s website is more specific and relates to “*all information the issuer, sponsor, or underwriter provides to the nationally recognized statistical rating organization, or contracts with a third party to provide to the nationally recognized statistical rating organization, for the*”

The information required to be included on the website is likely to include information provided orally to a hired CRA and its lawyers including discussions and negotiations with such CRA and its lawyers relating to the applicable transaction documents. This means that the process of information exchange between arrangers and hired CRAs will likely become more formalised, including the written submission of information that may, in the past, have been provided orally. Arrangers will need to implement procedures to ensure that all communications between hired CRAs and arrangers (including their respective lawyers) are contemporaneously posted to the applicable website.

Issuers and arrangers will also be concerned with the conditions on which a non-hired CRA can access the information on the website maintained by them. It is intended that the Commission will adopt detailed rules specifying the conditions of access and the requirements of the website in order to ensure the accuracy and the confidentiality of data and the protection of personal data¹³. Those proposed rules are yet to be published.

Finally, as is the case under Rule 17g-5 in the U.S., CRAs are only responsible to provide non-hired CRAs with access to the website maintained by the issuer or a related third party. Issuers and arrangers will be concerned about potential liability to non-hired CRAs (and potentially investors relying on ratings provided by such non-hired CRAs) in respect of the accuracy of information provided on its website and made available to such non-hired CRAs.

Other Proposed Changes

In addition to the proposed information requirements for structured finance instruments discussed above, the EU Commission's proposal to amend the CRA Regulation includes proposals to:

- transfer registration, supervision and enforcement powers from the Committee of European Securities Regulators ("CESR") and national authorities to the European Securities and Markets Authority ("ESMA"), the new financial regulator to be established at European level by the EU Commission;
- give more extensive supervision and enforcement powers to ESMA in the case of non-compliance with the terms of the CRA Regulation, including the power to impose fines, issue public notices and suspend the use of ratings for regulatory purposes; and
- add alternative investment funds to the list of entities which must use ratings issued in compliance with the CRA Regulation for regulatory capital purposes.

purpose of determining the initial credit rating for the security or money market instrument, including information about the characteristics of the assets underlying or referenced by the security or money market instrument, and the legal structure of the security or money market instrument, at the same time such information is provided to the nationally recognized statistical rating organization" (see Rule 17g-5(a)(3)(iii)(C), emphasis added).

¹³ See proposed Article 8a(3).

Timetable For Proposed Changes

The EU Commission's proposal will pass to the EU Council of Ministers and the European Parliament for consideration. If adopted, the new rules would be expected to come into force during 2011.

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We hope you find this helpful. Please feel free to contact any of the following Cadwalader attorneys if you have any questions about this memorandum.

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