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NFU Response to Consultation on Credit Rating Agencies

About NFU

Nordic Financial Unions (NFU) is an organisation for co-operation between trade unions that organise employees in the banking, finance and insurance sectors in the five Nordic countries. At present, eight trade unions are affiliated to the NFU; two in Denmark, two in Finland, two in Sweden, and one in each Iceland and Norway. Through these trade unions, NFU represents 160 000 employees in the Nordic financial market.

General remarks

Most of the questions asked by the Commission in the consultation paper are dealing with matters that are largely oriented towards the industry, and hence not for NFU to comment specifically.

In our reply, we have focused on matters that will, from our perspective, have an impact on employees in the finance sector now and in the future.

Question (7) Should firms be explicitly obliged to carry out their own due diligence and to have internal risk management processes in place which do not exclusively rely on external ratings?

Question (8) What information should be disclosed to supervisors in order to enable them to monitor the internal risk management processes of firms with particular focus on the use of external credit ratings in these processes?

Question (9) To what extent do firms currently use credit risk models for their internal risk management? Are the boards of directors or other governing bodies of these firms involved in the review of the use of credit ratings in their investment policies, risk management processes and in investment mandates?

Question (10) What further measures, in addition to the disclosure proposals included in Articles 8a and 8b of the proposal amending the current CRA Regulation could be envisaged?

With reference to the discussion in the consultation paper on the need for financial companies to have access to all the necessary information in order to perform their own credit risk assessments, NFU is of the opinion that it should be compulsory to set up a risk committee within the board of directors and establish rules regarding the composition and functioning of this committee. The establishment of such committees should also ensure the right to participation for employees.

The company gets an insight on how different issues are perceived from the employee perspective, and the employees get an overview on what the company is doing and how. Employee representation in the risk management of a company can provide very valuable insights from a supervision perspective. He/she is not only involved in the decision-making of the company, but also has access to direct information on the situation in the company from the employee perspective. Also, being representatives of a different group of people than normally would be the case in such a committee, employee representation ensures a bigger versatility of independence in the committee.

The role of employees in the risk management of financial companies has also been acknowledged in the Commission's regulation proposal on OTC derivatives, central counterparties and trade repositories, COM(2010) 484/5. In Article 26 it is pointed out that: "A CCP shall establish a risk committee, which shall be composed of representatives of its clearing members and independent members of the board. The risk committee may invite employees of the CCP to attend risk committee meetings in a non-voting capacity. The advice of the risk committee shall be independent from any direct influence by the management of the CCP."

It is necessary to strengthen the independence and authority of the risk management function in a company. NFU is of the opinion that employee representation ensures a bigger versatility of independence vis-à-vis management structures in a company. Employees should therefore have a clear role in the risk management system of a company.

Question (24) Could it be useful to explore ways in which the ECB would provide ratings to be used for regulatory purposes by European financial institutions? If yes, which asset classes (corporate, sovereign, structured finance instruments etc) could be considered?

Yes. All asset classes should be considered with focus on the specific assets or asset classes with the greatest market impact.

Question (27) Is there a need to create a new independent European Credit Rating Agency? If so, how could it be structured and financed and what entities and products should it rate (corporate, sovereign, structured finance instruments)? Should it be mandatory for issuers to obtain ratings from such a credit rating agency? What are the potential advantages and disadvantages of this approach?

In relation to the idea of establishing a Community Agency, NFU is of the opinion that within Europe at least one public rating agency should be established. It is important that the supervisory authorities are given swift and continuous information about the state of affairs regarding the operations by Credit Rating Agencies established within the Community. Therefore a system must be put in place where rating agencies are rated themselves.

A supervision mechanism without an early warning system will most likely turn out to be toothless, since the damage might already be done. The current financial turmoil has once again shown us how dysfunction in these markets has immediate effects on other areas of national economies. Generally speaking, we need a body to monitor the monitors. This could be done through the introduction of independent/public rating agencies. If the ratings of an independent rating agency differ from the ratings of a profit driven institution, it might be an indication that the rating methods of the latter needs to be examined.

Question (34) Do you agree that there could be a distorting influence of a fee-paying issuer over the determination of a credit rating?

Yes, there most certainly exists such a conflict of interest. Instead of decreasing asymmetric information in markets, this influence has in many cases led to an increase of incorrect information, if not to say fraudulent information, which has led and will lead to considerable negative external effects. This business model in its pure form should not be allowed to live on.

Question (35) What is your opinion on the proposed options/alternatives to reduce conflicts of interest due to the "issuer-pays" model? If so please indicate which alternatives appear to be the most feasible ones and why.

The alternative models all show potential and being untested it is hard to rank them. However the public utility model or the Government as Hiring Agent should certainly be explored as argued above while this should not exclude any of the other alternatives. The payment-upon-results and Trading Venues Pay are very interesting and could relatively easily be implemented. Perhaps a combination of these alternatives would be the most effective.

Yours faithfully,

Nordic Financial Unions (NFU)

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