A CRITICAL ANALYSIS OF THE RECENT RUSSIAN REGULATION ON CREDIT RATING AGENCIES

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Since the recent financial crisis of 2008, credit rating agencies (CRAs) have been under scrutiny for their role in the proliferation of structured finance products. Whether their methodological tools and evaluations have been up to standard is in question. As is well-known, CRAs are multinational enterprises that operate on a global basis. Their evaluations may well hinder the stability of international markets. As a legal response to the many concerns raised about CRAs, different approaches have been applied to the use of credit ratings in the US and EU with many similarities. In this international scenario, the government of the Russian Federation also recently introduced a new regulation on CRAs, drafted on the lines of the European regulation. This short paper is targeted to inform the reader of certain aspects of the newly approved regulation in Russia and to examine – in a comparative way – whether the introduced rules match the expectations behind the initiatives of the Russian government.

Key words: CRAs; rating; issuer-pays conflict; rating shopping; financial regulation; liability of intermediaries; competition.

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1. Introduction

Since the global financial crisis of 2008, the role of Credit Rating Agencies (CRAs) has been examined very closely by a large part of the legal and economic doctrine, both theoretically and empirically, mainly because of their involvement in the market turmoil. In particular, CRAs have been criticized for their contribution to the proliferation of structured finance products in the global market, and for their poor credit assessment.[1]

Over the years, CRAs have grown in size and power in a heavily concentrated market for ratings, in which Moody's and Standard & Poor's have dominated as a duopoly, with Fitch as the only other major player. This scenario has been facilitated by the huge fixed costs to enter in the industry and the inclusion of credit ratings in bank capital regulation.[2] Credit ratings have developed in terms of their use and

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[1] In the view of the Financial Stability Forum (FSF) '[…] *poor credit assessment of complex structured credit products by CRA contributed to both the build-up and the unfolding of the financial crisis*', See *Report of the FSF on Enhancing Market and Institutional Resilience* (7 April 2008) <http://www.financialstabilityboard.org/publications/r_0804.pdf>; *see also* CESR, *CESR's Second Report to the European Commission on the compliance of credit rating agencies with the IOSCO Code and the role of credit rating agencies in structured finance, update to the code of conduct* (May 2008) <www.cesr-eu.org/data/document/CESR_08_277.pdf> and The European Securities Markets Expert Group (ESME), *Report to the European Commission, Role of Credit Rating Agencies* (June 2008). <http://ec.europa.eu/finance/securities/docs/esme/report_040608_en.pdf>; CGFS (Committee on the Global Financial System), *Ratings in Structured Finance: What Went Wrong and What Can Be Done to Address Shortcomings?* 32 CGFS Paper (2008) <http://www.bis.org/publ/cgfs32.pdf>; FSA (UK Financial Services Authority), *The Turner Review: A Regulatory Response to the Global Banking Crisis* (London 2009) <http://www.fca.org.uk/static/pubs/other/turner_review.pdf>; M.K. Brunnermeier, A. Crockett, C. Goodhart, A.D. Persaud and H.S. Shin, *The Fundamental Principles of Financial Regulation*, Geneva Report on the World Economy (2009) <http://www.princeton.edu/~markus/research/papers/Geneva11.pdf>. Among the commentators *see* Darbellay A. *A Regulating credit rating agencies* ch. 4 to 6 (Cheltenham: Edward Elgar Publishing 2013); Iris H-Y Chiu, *Regulatory Governance of Credit Rating Agencies in the EU: The Perils of Pursuing the Holy Grail of Rating Accuracy,* 2 The European Journal of Risk Regulation 209 (2013); Alcubilla R.G. and J.R. del Pozo, *Credit Rating Agencies on the Watch List: Analysis of European Regulation* ch. 5 p. 246 (Oxford, OUP, 2012); Darbellay A. and F. Partnoy, *Credit Rating Agencies and Regulatory Reform* in *Research Handbook on the Economics of Corporate Law* 294 (Claire A. Hill and Brett H. McDonnell eds., Cheltenham: Edward Elgar 2012); Partnoy F. *Rethinking regulation of credit-rating agencies: an institutional investor perspective*, 25 Journal of International Banking Law and Regulation 190 ff. (2010); Hunt J.P. *Credit Rating Agencies and the 'Worldwide Credit Crisis': the Limits of Reputation, the Insufficiency of Reform and a Proposal for Improvement*, Columbia Business Law Review 109, 112–114, 127–128 (2009) <http://cblr.columbia.edu/archives/10923>; Amtenbrink F. and J. De Haan, *Regulating Credit Ratings in the European Union: A Critical First Assessment of Regulation 1060/2009 on Credit Rating Agencies*, 46 Common Market Law Review 1943 ff. (2009) <http://www.kluwerlawonline.com/abstract.php?area=Journals&id=COLA2009077>.

[2] See Basel Committee on Banking Supervision (BCBS), *International Convergence of Capital Measurement and Capital Standards* (1988) <http://www.bis.org/publ/bcbsc111.htm>; Basel Accord and BCBS, *Amendment to the Capital Accord to Incorporate Market Risks* (1996) (Basel I) <http://www.bis.org/publ/bcbs24.htm>; and BCBS, *Application of Basel II to Trading Activities and the Treatment of Double Default Effects* (2005) (Basel II) <http://www.bis.org/publ/bcbs111.pdf >.

application since they first came into existence. They appeared in the market as qualified financial opinions. However, as debt markets expanded, myriads of complex financial instruments have been created, all requiring a rating to be distributed to retail investors. The importance of ratings as a regulatory stamp has grown *pari passu* with their convenience, and their applicability has been built into financial arrangements of all kinds, even as a valid trigger signal to dismiss an investment. Unfortunately, when the financial crisis materialized, the strong reliance on CRAs in highly interconnected financial markets trapped many financial institutions in liquidity crises as a result.[3]

In response to the global financial crisis and to the many concerns raised by CRAs' activity, different approaches have been applied to the use of credit ratings in financial market regulations in the European Union and the United States. In Europe, aiming at ensuring "that credit ratings used in the Community are independent, objective and of the highest quality", three new regulations have been promulgated at both national and supranational levels, imposing legally binding obligations on CRAs. These are: Regulation 1060/2009 (CRA I),[4] Regulation 513/2011 (CRA II)[5] and Regulation 462/2013 (CRA III).[6] Different is the case of the US, where the approved Dodd-Frank Act of 2010[7] – acknowledging the inconsistency of a rating-based regulation with the proper functioning of market forces in the rating industry – in order to reduce over-reliance on ratings, has removed regulatory references to rating from financial regulations.[8]

Against this international background, the government of the Russian Federation has also taken action, approving a new framework for CRAs drafted on the lines of the initial European regulation. Having in mind the EU and US experiences regarding CRA regulation, this article offers comment on certain aspects of the recently introduced CRA regulation in Russia as a regulatory response to the failure of CRA activities. The analysis starts by providing some background on the function of CRAs, and related criticisms raised following the last financial crisis. The new Russian regulatory framework for CRAs is then presented and examined. This is followed by some concluding considerations.

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3 Weber R.H. and A. Darbellay, *The regulatory use of credit ratings in bank capital requirements regulations,* 10 J. Banking Regulation 10 ff. (2008). DOI: 10.1057/jbr.2008.22.

4 See the European Parliament and Council Regulation (EC) 1060/2009 (O.J. 2009, L. 302/1) entered into force on 7 December 2009.

5 [2011] OJ 2011 L145/30.

6 [2013] OJ 2013 L146/1.

7 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, HR 4173, 111th Congress, 2d Session (2010) (Dodd-Frank Act) Sections 931–939H (Title IX, Subtitle C 'Improvements to Regulation of Credit Rating Agencies').

8 Dodd-Frank Act of 2010, Sec 939–939A.

2. The Function of Credit Rating Agencies

A credit rating is an opinion regarding the creditworthiness of an issuer, or of its debt or financial obligation, preferred share or other structured financial instrument. The probability of default of a company is used to classify each of the financial instruments issued into a certain risk-rating class. These classes are expressed on a scale of letters and figures from AAA (highest rating) to D (lowest rating). Depending on the risk-rating class assigned to an issuer, the market fixes the 'premium' due by the company to compensate an investor for supporting that risk, that is the payable interest rate. Therefore, ratings play a crucial role in financial markets, as institutional and non-institutional investors use them to evaluate the credit risks of financial instruments. The assessment of these instruments requires specific knowledge and is highly time-consuming, making it attractive for investors to rely on the ratings by CRAs. From an economic perspective, by providing information on the rated security, credit ratings are aimed at reducing information asymmetries between investors and the issuer, which can lead to so-called 'adverse selection' problems. In the process of raising funds, the management (agent) of the firm issuing a security holds private information regarding the risk of the investment. If the investor cannot accurately gauge the quality and the risk of the investment to subscribe, they will ask the issuer for a higher return. CRAs provide investors with a tool for screening and in so doing reduce the premium (interest rate) paid by issuers. [9]

CRAs also perform a kind of audit function through the use of their ratings, which can upgrade or downgrade the creditworthiness of a firm. This function is targeted to mitigate the so-called 'collective action' problems of dispersed debt for investors by helping them to monitor performance, with downgrades serving as a signal to take action. At the same time, by rating a security and the creditworthiness of an issuer, they cap the amount of risk that the agent can take on behalf of the principal. For these reasons, nowadays credit ratings issued by a recognized rating agency are typically among the main tools used by portfolio managers in their investment decisions, and by lenders in their credit decisions.[10]

If we look at rating agencies from a regulatory perspective, CRAs perform a *quasi*-regulatory function. By rating periodically the risk of default of financial institutions and public companies, they contribute indirectly to the prudential supervision carried out by the host country's central banks and financial service authorities. In fact, under the Basel II agreement of the Basel Committee on Banking Supervision, regulators can allow banks to use credit ratings from certain approved CRAs (called External

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9 Partnoy F. *The Siskel and Ebert of Financial Markets? Two Thumbs Down for the Credit Rating Agencies*, 77 Washington University Law Quarterly 644 (1999).

10 However, these collection active problems could be also substantially reduced with the use of covenants in the bond's issues. The breach of covenant could work as a perfect trigger for the creditor.

Credit Assessment Institutions, or ECAIs) when calculating their net capital reserve requirements.[11] The idea is that banks and other financial institutions should not need to keep in reserve the same amount of capital to protect the institution against, for example, a run on the bank, because not all firms share the same risk. If the financial institution is heavily invested in highly liquid and very 'safe' securities, such as government bonds or short-term commercial paper from very stable companies, it will be required to keep in reserve less net capital.

Before the introduction of the latest European regulation on rating agencies (CRA III), part of the doctrine compared the monitoring function of CRAs to the control procedures carried out by audit companies.[12] It has been said that while they share a similar power, both being financial intermediaries acting in a highly concentrated market, they do *not* share a similar liability. However, CRAs have traditionally shielded themselves from investors' litigation, and until a few years ago, prevented direct regulation of their operations simply by claiming that their status is the same as financial journalists and, as such, they are protected by the constitutional guarantee of freedom of the press. They contended that this protection precluded government regulation of the content of a rating opinion or the underlying methodology. In fact, CRAs do not have the same power of investigation assigned to audit companies. They often did not base their ratings and research on official and public data, in particular for the structured finance for which most of the material analysed was private and unaudited. Surely and unfortunately, the real meaning of CRAs' ratings had been widely misinterpreted by the market also because of the regulatory involvement of the rating. The rating, while assessing the credit default risk, did not cover market and liquidity risks. Since market liquidity and price volatility were not considered, bonds with the same rating might have very different market prices. For example, a government debt holding a very high rating (AAA) might have a different and generally superior overall quality, as compared with the same rating of senior tranches of a collateralized mortgage obligation (CMO). Despite this fact, and even though each rating agency has its own rating methodologies and scales, market participants have often treated similarly rated securities as generally fungible.[13] That said, there are several concerns raised by CRAs that deserve serious consideration, as described in the next section.

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11 In the United States, the SEC permits investment banks and broker-dealers to use credit ratings from 'Nationally Recognized Statistical Rating Organizations' (or NRSROs) for similar purposes.

12 Leyens P.C. *Intermediary Independence: Auditors, Financial Analysts and Rating Agencies*, 11(1) Journal of Corporate Law Studies 33–36 (2011). DOI:10.5235/147359711795344145.

13 Partnoy F. *How and Why Credit Rating Agencies Are Not Like Other Gatekeepers*, 07–46 San Diego Legal Studies Research Paper (2006) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=900257>; Alexander Kern, *The Risk of Ratings in Bank Capital Regulation*, 25 European Business Law Review 304–305 (2014) <http://www.kluwerlawonline.com/abstract.php?area=Journals&id=EULR2014011>; Goodhart C.A.E. *The regulatory response to the financial crisis* 121 (Cheltenham, Edward Elgar Publishing Ltd. 2009).

3. The Main Criticisms of the Credit Rating Industry

According to the Larosiere Report,[14] CRAs contributed to the causes of the financial crisis, because they fuelled the development of the structured finance market with ratings based on inappropriate methodologies that lowered the perception of credit risk.[15] Indeed CRAs failed to correctly evaluate the risks associated with banks' changed business models, especially due to the application of traditional risk-assessment models to new – far more complex – financial instruments.[16] Their methodology had two aspects: a focus on the permanent component of default risk and a prudent migration policy. Based on the first aspect, agency ratings disregard short-term fluctuations in default risk. By filtering out the temporary component of default risk, they measure only the permanent, long-term and structural component. The second aspect concerns the enhancement of rating stability by a prudent migration policy. According to this, only substantial changes in the permanent component of default risk lead to rating changes and, if triggered, ratings are partially adjusted to the actual level in the permanent component of default risk. This explains the delays in CRAs downgrading debt securities until just before insolvency.[17]

Another reason for the slow reaction of CRAs in the middle of the financial turmoil was the systemic impact of credit ratings. As debt markets have expanded, ratings have been built into financial arrangements of all kinds. For example, many banks had built so-called "ratings triggers" into their loan agreements. These meant that, if something happened to lower the borrower's creditworthiness to a specified level, the loans could have been called in. In time of crisis, and with capital markets highly

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14 *See* Basel: Bank for International Settlements: de Larosiere Group, *Report of the High-Level Group on Financial Supervision in the EU* 9 (Brussels, February 2009) <http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf>.

15 The weaknesses concerning the credit assessment of complex structured credit products were highlighted also by the Financial Stability Forum. See *Report of the FSF on Enhancing Market and Institutional Resilience* (7 April 2008).

16 In the view of the Financial Stability Forum (FSF) '[…] *poor credit assessment of complex structured credit products by CRA contributed to both the build-up and the unfolding of the financial crisis*', in *Report of the FSF on Enhancing Market and Institutional Resilience* (7 April 2008) <http://www.financialstabilityboard.org/publications/r_0804.pdf>; see also Committee of European Securities Regulators (CESR), *CESR's Second Report to the European Commission on the compliance of credit rating agencies with the IOSCO Code and the role of credit rating agencies in structured finance, update to the code of conduct* (May 2008) <www.cesr-eu.org/data/document/CESR_08_277.pdf>; The European Securities Markets Expert Group (ESME), *Report to the European Commission, Role of Credit Rating Agencies* (June 2008) <http://ec.europa.eu/internal_market/securities/esme/index_en.htm>; Committee on the Global Financial System (CGFS), *Ratings in Structured Finance: What Went Wrong and What Can Be Done to Address Shortcomings?* 32 CGFS Paper (2008) <http://www.bis.org/publ/cgfs32.htm>; Financial Services Authority (FSA), *The Turner Review: A Regulatory Response to the Global Banking Crisis* (London, 2009) <http://www.fca.org.uk/static/pubs/other/turner_review.pdf>. For an analysis see Weber R.H. and A. Darbellay, *The regulatory use of credit ratings in bank capital requirements regulations* (n.3) 1; Partnoy F. (n.1) 4 (2010).

17 Goodhart C.A.E., *The regulatory response to the financial crisis* (n.13) 129.

interconnected, this effect could have easily created default situations and liquidity crises. For these reasons, CRAs were rightly reluctant to downgrade because of the impact on the triggers, which were usually not publicly disclosed, in private financial contracts, even if the downgrade was already reflected in market prices.[18]

Nevertheless, as doctrine has stressed, the recent structured finance failures are only the last of a series of failures to foresee severe financial problems. The CRAs' slow reaction to market events has raised the question of whether regulators and market participants should rely on credit ratings at all. In addition, from a macroeconomic perspective, credit ratings as well as other capital requirements (Basel I and II) have been said to be pro-cyclical in their nature, or 'through the cycle' indicators. For this reason they contribute to systemic risk in a global market, such as financial markets where financial agents and institutions are extremely interconnected. The riskiness of assets varies over the business cycle and risk assessments based on external evaluation by CRAs reflect this pro-cyclicality. The pro-cyclical approach of ratings creates a similar pro-cyclical approach in capital charges, with the implication that banks hold less capital or over-lend at the cusp of a cycle – exactly when the danger of a systemic crisis is largest – while they hold too much capital or under-lend during the downturn – when macroeconomic stabilization requires an expansion in lending.[19]

Some scholars have argued that CRAs' poor rating performance can be explained by the limited competition in this industry.[20] Indeed CRAs operate in an oligopolistic market that offers limited incentives to compete on quality ratings. As regards market structure, there is no doubt that the rating industry is heavily concentrated. The three largest companies, Moody's, Standard & Poor's and Fitch, *de facto* dominate the market.[21] Although it has been said that the level of rating prices was low in absolute terms, these companies have been extremely profitable compared to the value of the financial information provided to the markets. Their behaviour has raised doubts as to whether CRAs are driven only by private market forces.[22] From a different point of view, it has been argued that an excess of competition would lower not only the

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18 Look at the downgrading of AIG's debt on September 16, 2008 that triggered collateral calls on credit default swap contract provisions that AIG had with banks around the world forcing the US Federal Reserve to inject new liquidity to save the company.

19 Goodhart C.A.E., *The regulatory response to the financial crisis* 4(4) Journal of Financial Stability 351–358 (2008). DOI: 10.1016/j.jfs.2008.09.005. See the Financial Economists Roundtable (FER), *Reforming the Role of the Statistical Ratings Organizations in the Securitization Process* (Statement released the 1st December 2008, Philadelphia) <http://fic.wharton.upenn.edu/fic/Policy%20Page/FER12%201%2008rev.pdf>.

20 For literature on the topic, see Darbellay, *A Regulating credit rating agencies* (n.1) 207 ff.

21 In 2012 they shares accounted for the 96% of all outstanding ratings in the US, see Staff of the SEC, 2012 *Summary Report of Commission Staff's Examinations of Each Nationally Recognized Statistical Rating Organization, As Required by Section 15E(p)(3)(C) of the Securities Exchange Act of 134* 7 (November 2012).

22 Darbelley, *A Regulating credit rating agencies* (n.1) 215.

price but also the quality of ratings, resulting in a 'race to the bottom'.[23] In truth, in a market for ratings in which competition incentives work adequately, CRAs' success and credibility strongly depend on their reputation. In fact – as many scholars have stressed – a competitive rating market is based on reputation-driven business.[24]

Despite these arguments, a strong reliance on CRAs due to a lack of understanding was apparently also shared by the regulators that linked bank capital requirements to ratings, generating a heavy dependence of the market on them. Under Pillar I standardized approach of Basel II, if the bank's commitments to its obligors are highly rated, the bank is required to hold less regulatory capital. Therefore, the purpose of obtaining a high rating had a twofold benefit for issuers. First, to lower the overall cost of capital and in so doing increase the share value, make the balance sheet appear safer and be able to take on more debt. Second, to make the issuer more appealing to the market, which means being able to sell to a larger range of investors. For instance, mutual funds and government-run pension funds often restrict their investments to certain grades of bonds.[25]

As underlined by much of the literature, one great cause for concern arises from the conflict of interest inherent in the relationship between banks, rating agencies and investors – the so-called *issuer-pays* business model.[26] The ratings were for the use of investors, but the issuers paid for them, meaning that the same banks made more profit when a higher rating was assigned to their financial products by a CRA, which in return made more profit pleasing the issuers with high ratings and thus having more financial products to rate. This agency conflict could have (and probably did) generate *inflated* credit ratings as a consequence of the fact that CRAs have more interest in helping issuers than in warning investors against potential losses.[27]

In the last two decades, financial institutions in need of raising fresh finance have fuelled markets with a myriad of structured credit products to take advantage of the

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23 Hunt J.P., *Credit Rating Agencies and the 'Worldwide Credit Crisis'* (n.1) at 109, 112–114, 127–128. *See also* Bolton P., X. Freixas, J. Shapiro, *The Credit Ratings Game*, 67(1) The J. of Fin. 85–110 (2012).

24 Schwarcz S.L. *Private Ordering of Public Markets: The Rating Agency Paradox,* 2 University of Illinois Law Review 1, 26 (2002); Jackson H.E. *The Role of Credit Rating Agencies in the Establishment of Capital Standards for Financial Institutions in a Global Economy* in *Regulating Financial Services and Markets in the 21st Century* 312 (Eilis Ferran and Chares A.E. Goodhart (eds.), Hart Publishing 2001); Partnoy F., *The Siskel and Ebert of Financial Markets? Two Thumbs Down for the Credit Rating Agencies* (n.9) 627.

25 Weber R.H. and A. Darbellay, *The regulatory use of credit ratings in bank capital requirements regulations* (n.3) 10 ff.

26 *See* IOSCO, *Code of conduct: Fundamentals for Credit Rating Agencies*, December 2004, section 3.5 and 3.7 <www.iosco.org/library/pubdocs/pdf/IOSCOPD180.pdf>.

27 For a review of the literature see Darbellay A. and Partnoy F. *Credit Rating Agencies and Regulatory Reform,* University of San Diego Legal Studies Research Paper Series, Research Paper No. 12–083 (April 2012); Alexander Kern, *The Risk of Ratings in Bank Capital Regulation,* 24 European Business Law Review 305–306 (2013) (n.13); Partnoy F. *Overdependence on credit ratings was a primary cause of the crisis*, 27 Fondazione Eni Enrico Mattei Nota di Lavoro (2009).

different risk preferences of investors, and CRAs were paid to give these issuers their certified stamp. The problem was that investors viewed debt products with the same credit rating as fungible and, as a consequence, even the most complex and opaque financial instrument could be sold as long as it received a certain investment-grade rating. The lack of transparency and great complexity in this market, and the great appetite of investors for high rates of return at a time of low interest rates, ensured a heavy reliance by market participants on rating agencies.[28]

The rating-based regulation for banks and financial institutions on the one hand, and the high demand for highly rated products on the other, had the result of developing a market for securitized debt. Securitization transactions grew enormously in a short period, dramatically increasing the revenue stream and profitability of rating agencies. This growing business prompted financial institutions to relax credit-underwriting standards by relying on the assessment of external CRAs instead of collecting information on borrowers, and to expand into higher-risk market segments in order to originate loans solely for the purpose of securitizing them – the so-called 'originate to distribute' model.[29] Credit ratings were therefore critical to the development of securitization and structured financial products. If CRAs had denied, or issued some negative ratings, banks would have not been able to profitably sell on individual loans that were generally not granted direct access to the capital markets. Thus, the result of the rating-dependent regulation has been to weaken the monitoring role of banks as financial intermediaries while providing them with a great incentive for engaging in creative financial engineering. By structuring a deal in such a way as to obtain a higher credit rating, the issuers were able to transfer the risk to the investors.[30]

4. The Regulatory Response to Rating Agencies' Failures

In response to CRAs' failures, authorities in the Russian Federation have introduced a detailed range of regulatory measures in line with initial regulation introduced in the EU.[31] The measures have been mainly targeted to manage the conflicts of interest. They include governance reforms in rating agencies, the improvement of the quality of rating methodologies for structured finance, increased transparency and disclosure obligations and the introduction of direct government oversight to replace self-regulation. The new

28 Goodhart C.A.E., *The regulatory response to the financial crisis* (n.13) 121.

29 Partnoy F. *Overdependence on credit ratings was a primary cause of the crisis*, 27 Fondazione Eni Enrico Mattei Nota di Lavoro (2009).

30 Weber and Darbellay (n.3) at 18.

31 Federal'nyi zakon RF o deyatel'nosti kreditnych agentstv v Rossiiskoi Federatsii [Federal Law of the Russian Federation on 'The activities of the rating agencies in the Russian Federation']. Rossiiskaia Gazeta [Ros. Gaz.] July 17, 2015. Compare to (EC) Regulation 1060/2009 of the European Parliament and of the Council of credit rating agencies, O.J. 2009, L 302/1.

Russian Federation Law (RFL) on CRAs is applicable from the date of its publication (July 2015). The Regulation is divided into four main chapters: Chapter 1 – General Provisions (art. 1 and 2); Chapter 2 – Operating Environment of Credit Rating Agencies (art. 3 to 14); Chapter 3 – Regulation and Supervision of Credit Rating Agencies (art. 15 and 16); and Chapter 4 – Final Provisions (art. 17 to 20). As a rule, all CRAs that would like their credit ratings to be applied in the Russian Federation will have to be registered in accordance with the requirements of the Central Bank of Russia (CBR).[32]

The applications will be submitted directly to the CBR, which will have to grant every rating agency a judgement of conformity with Russian requirements, and will be involved in the day-to-day supervision of those entities. The RFL lays down the conditions and the procedure for granting, refusing, suspending and withdrawing registration.[33] The CBR can reject an application on the basis that an applicant does not demonstrate by documentation a complete conformity to the governance, methodology and ownership criteria defined in the law. In addition, the RFL imposes several requirements of disclosure on CRAs.[34] Registered rating agencies will have to comply with rigorous rules to make sure that (i) ratings are not affected by conflicts of interest, (ii) the quality of their rating methodology and their ratings does not deteriorate, and (iii) they act in a transparent manner. First of all, the regulation requires special disclosure of the CRA ownership structure. In particular, article 6 of the RFL explains how to become shareholder of a rating agency without being *de facto* in a situation of conflict of interests. An individual controlling directly or indirectly – through a company, a shareholders' agreement or on a fiduciary basis – more than 10 per cent of the voting rights in a rating agency must *not* invest in another rating agency or exercise any kind of influential power over financial institutions or organizations.[35] All investors holding more than 10 per cent of the voting rights must declare themselves to the CBR, which in the case of a *persona non grata* can apply to the courts to reduce their voting power as appropriate.[36] Financial institutions, investment firms, insurance, assurance and reinsurance undertakings holding a share in a CRA cannot – in any case – increase their shareholding above 20 per cent in terms of voting rights.[37] The CBR has the right to a judicial remedy for any act or collective decision of a CRA's shareholders' meeting taken in contravention of the formal requirement.[38]

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32 RFL article 4. Similar article was included in EU Regulation (CRA I), see art. 4(1) of the Regulation.

33 RFL articles 15 and 16. The same content is included in CRA I, articles 14 to 20.

34 RFL articles from 5 to 12. They match with CRA I, art. 8.

35 RFL art. 6 section 1. Control and influential power are concepts as determined by the International Financial Reporting Standards (IFRS) see art. 6 sub2. Same approach is taken in the EU, where policy-makers also wish to prohibit cross-ownership of credit rating agencies so that CRA would remain independent of one another. See CRA I, art. 6a.

36 RFL article 6 section 4. In the EU, see CRA I, art. 3(1)(j).

37 *Id.*, art. 6 section 6.

38 *Id.*, art. 6 sections 7, 8, 9.

Second, like CRA I,[39] the RFL sets out certain requirements for rating agencies, including the establishment of executive and supervisory boards, internal controls and compliance functions. Directors and members of the executive and supervisory boards of CRAs hold fiduciary duties towards the company and must act in the *bona fide* best interest of the company. They must comply with the highest reputational standards for professionals involved in the management of financial intermediaries.[40] All nominations proposed for positions on the internal control and risk management units must be communicated to the CBR within three days of the appointment for approval, which must arrive within a month. Their dismissal from the position or termination of powers must be communicated to the CBR no later than the next working day.[41] The CBR has the right to ask CRAs to replace one or more individuals involved on the boards in the case of them no longer meeting the minimum requirements for eligibility.[42] The control over financial accounts can be outsourced, but only to a physical person not under the control of the CRA who fulfils the international professional standards for this role. If it is outsourced to a company, that company must have among its players a physical person fulfilling the professional standards required and taking full responsibility for its mission.[43] For CRAs with more than twenty employees, at least one third of the advisory and executive board of directors, or a minimum of two individuals, must be independent non-executive directors.[44] Independent non-executive directors must not be involved in any other CRA's activity or any municipal or public entity.[45] They cannot be elected for more than five consecutive years or for a more than a total of seven years.[46] Their duty is to remain vigilant with respect to the quality of their rating methodologies and ratings, and to enable their procedures and controls to prevent, identify and solve any potential conflict of interest.[47] Their remuneration must not be linked to the performance of the credit rating agency and should be defined so as to guarantee independence in their judgement.[48]

Articles 9 to 14 continue the mission of improving the operational environment of the rating industry. Accordingly, they establish a general duty of rating agencies to

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39 See CRA I, art. 6 and section A and B of Annex I.

40 The RFL defines at art.7 section 1sub sections 1-15 all requirements to be considered eligible for the position.

41 *Id.*, art. 7 sections 2, 5, 6 and 7.

42 *Id.*, art. 7 section 3.

43 *Id.*, art. 7 section 8.

44 *Id.*, art. 8 section 2.

45 *Id.*, art. 8 section 3.

46 *Id.*, art. 8 section 4.

47 *Id.*, art. 8 section 5.

48 *Id.*, art. 8 section 6.

ensure that their ratings are not tainted by any actual or potential conflict of interest or business relationship involving the CRA issuing the rating, its managers, rating analysts and employees. Detailed requirements are set out for rating agencies to demonstrate their independence. In the absence of those requirements, the CRA cannot assign a rating to an entity, or the rating assigned in conflict of interest will not be disclosed to the market.[49] Several clear cases of conflicts of interest are described in the regulation. For instance, if the rated entity exerts considerable influence over a CRA, it is in a conflict of interest position.[50] The same applies if an employee whose services are placed at the disposal of or under the control of the CRA is related to a member of the supervisory board of the rated entity or related third party.[51] CRA founder members holding more than 10 per cent of voting rights are not allowed to rate entities in which they own – either directly or indirectly – more than 10 per cent of voting rights or in which they have any other similar indirect ownership interest.[52] Likewise, no rating can be issued if the entity to be rated is a creditor of the CRA for an amount higher than 10 per cent of the total turnover generated by the CRA's activity.[53] Mutual and pension funds as well as common investment funds are exempted from these restrictions.[54] Other requirements state that the remuneration paid to CRAs should not depend on the rating assigned,[55] and CRAs are not allowed to provide their clients with consultancy or advisory services.[56] In Russia, CRAs will have to be pre-emptively authorized by the CBR for any additional service they would like to offer.[57]

Similar requirements to those applying to directors also exist for financial analysts. Articles 10 to 12 define the professional requirements and independence criteria that financial analysts must fulfil in order to become part of CRAs' rating committees. Financial analysts develop their activities through the rating committee formed by at least five rating analysts, where the president of the committee takes the final decision regarding the rating to be issued according to the modalities described in the internal credit rating procedures, and in conformity with the requirements of the CRA Regulation and the CBR Regulation.[58] A financial analyst whose services are placed at the disposal of or under the control of a CRA cannot hold shares or

49 *Id.,* art. 9 section 3. Similar articles exist in CRA I, see Annex I, Section B, para.3.

50 RFL art. 9 section 3 sub 1.

51 *Id.,* art. 9 section 3 sub 5.

52 *Id.,* art. 9 section 3 sub 6.

53 *Id.,* art. 9 section 3 s. 8.

54 *Id.,* art. 9 section 7.

55 *Id.,* art. 9 section 8.

56 *Id.,* art. 9 section 12.

57 *Id.,* art. 9 section 11.

58 *Id.,* art. 11 sections 1 and 7.

other financial instruments of the rated entity or hold any position on the board.[59] A financial analyst cannot rate an entity if they have had a business relationship with the same entity within the last 12 months.[60] They must be independent in their decisions and not influenced by any marketing or commercial policies[61] or members of the executive or advisory board.[62] They must rotate their rating activities in order not to be involved in the rating of the same entity for more than four years, or five in the case of sovereign rating.[63] Their remuneration must not depend on the profit gained through fees obtained by clients.[64] They cannot hold shares or any ownership interest in CRAs.[65] They cannot receive gifts with a face value of more than 3,000 roubles.[66]

In order to increase transparency in the market, the RFL imposes several disclosure obligations on CRAs regarding the methodologies, models and key assumptions used in the rating process. These methodologies will have to be rigorous, systematic and continuous, and subject to validation based on historical experience.[67] CRAs must establish internal arrangements to monitor and review the impact of changes in macroeconomic or financial market conditions on credit ratings.[68] If CRAs decide to change their rating methodology they must immediately disclose which ratings are likely to be affected by this change and re-rate them promptly.[69] They will have to constitute an internal methodology committee that is independent from the rating committee and the executive/advisory boards.[70] All information and documents regarding the members of the rating committee and the methodologies adopted must be communicated to the CBR.[71] The public authorities of the Russian Federation and global and local regulators such as the CBR and the local governments have no right to influence the content of the credit rating issued and the methodologies used

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59 *Id.,* art. 10 section 10.

60 *Id.,* art. 10 section 2. In the EU see CRA I Section C, Annex I.

61 *Id.,* art. 11 section 2. In the EU, see CRA I art. 7(2).

62 *Id.,* art. 10 section 4.

63 *Id.,* art. 10 sections 5 and 6. A similar mechanism of rotation is implemented in Europe, see CRA III art. 6 and Para 8, Annex I, Section C where it is proposed CRA themselves to rotation every 4 years.

64 RLF, art. 10 section 7.

65 *Id.,* art. 10 section 8.

66 *Id.,* art. 10 section 9. In the EU see CRA I, Para 4, Annex I, Section C.

67 RLF, art. 12 sections 1 to 5. In CRA I this is stated in art. 8(3).

68 RLF, art. 12 sections 8 to 11. In CRA I this is stated in art. 8(5).

69 RLF, art. 12 section 12. In CRA I this is stated in art. 8(6).

70 The methodology committee cannot develop any commercial or marketing function in the credit agency. See art. 12 sections 13 and 14.

71 See RFL art. 12 section 15.

by CRAs.[72] However, the CBR must agree on the appropriateness of all information disclosed.[73] Additional periodical disclosures include data on CRAs' historical performance and default rates of rating categories, and a list of their largest clients by revenue composing more than 5 per cent of their annual turnover.[74] Finally, every year – before the end of March – CRAs must prepare a report containing information on their capital structure, internal controls and audit, ratings assigned and revised, directors and members of the boards, any rotation of their financial analysts, and the turnover of the year ended.[75] This report is presented to the CBR, which has the right to disclose the data on their website.[76]

For the particular task of issuing sovereign ratings, CRAs will have to follow an approved calendar to be agreed with the CBR as appropriate.[77] If the rating is unsolicited, the CRA will have to mention it.[78] In any case, the CBR has the right to add supplementary requirements for the disclosure of certain ratings.[79] These provisions are intended to achieve a compromise between the political interest in ratings of sovereign debt and the maintenance of objectivity and independence in its regulatory regime. The provisions will prevent situations of rating downgrades driven by superficial perceived dangers that do not take into account the country's economic context and unique features. These scenarios have a systemic risk impact and therefore should be avoided.

5. A Comparative Evaluation of the Russian Regulation on Credit Rating Agencies

The areas for improvement in relation to CRAs involve promoting competition in the credit rating industry, solving the conflicts of interest (due to the issuer-pays business model) and reducing the regulatory franchise of rating agencies.[80]

Russian, American and European regulation require rating agencies to register on a list of companies authorized by a financial supervisor, which for Russia will be

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72 RLF, art. 12 section 17. Same statement is found in CRA I, Recital 23, art. 23.

73 *Id.*, art. 13 section 1 where is provided a list of information that need to be disclosed.

74 *Id.*, art. 13 section 3. CRA I states similar requirements at art. 11(2) and Annex I, Section E, Pt II.

75 *Id.*, art. 13 section 4. For CRA I see art. 11(2) and Annex I, Section E, Pt III.

76 *Id.*, art. 13 section 8.

77 *Id.*, art. 14 section 4. In the EU a similar requirement was introduced with the amendments of CRA III in 2013 (art. 8a) according to which rating agencies have to set three dates in advance for publishing any unsolicited sovereign debt rating.

78 *Id.*, art. 14 section 5.

79 *Id.*, art. 14 section 6.

80 Hunt J.P., *Credit Rating Agencies and the 'Worldwide Credit Crisis'* (n.1) 109.

the CBR. This licence will hopefully increase the number of players in the industry and, therefore – by increasing competition – will reduce the great power that CRAs have acquired over the years. However, as doctrine has pointed out, size and market recognition may be greater barriers to entry than regulatory status.[81] Furthermore, the process of promoting competition in the industry is highly influenced by the other two issues – the issuer-pays business model and the rating-based regulation for financial institutions. In fact, these three areas of intervention are strictly interconnected. A blind increase of competition without addressing the other issues may prove a trivial exercise. As long as CRAs receive their payments from issuers, a strategy of increasing competition might actually lower the quality of ratings. The reason for this is that new entrants would probably compete by offering higher ratings or by lowering prices. By doing so, both the level of effort in ratings and their reliability would be compromised.[82] Additionally, the reputational incentives for CRAs would be proportionally reduced by the increase in competitors.[83] Finally, it has been said that a limited number of global CRAs promote greater consistency and uniformity in ratings across markets, making it easier for investors to compare debt securities issued in different countries.[84]

This is why countries will not only have to apply competition and anti-trust law *sensu stricto*. It will also be important to avoid take-over attempts by major players of newcomers, as well as any abuse of a dominant position and anti-competitive agreements between CRAs. However, it will be essential to implement competition policies targeted to provide market players with appropriate incentives to compete.[85] Ideally, a competitive rating market requires as few barriers to entry as possible and a natural extinction of CRAs not providing quality ratings.[86] As some scholars have noted, rating scandals originated mostly from market failures, which were structural, and only in small part from anti-competitive practices.[87]

For instance, the issuer-pays model fundamentally compromises the objectivity of the rating process, creating serious concerns for maintaining reputational capital.

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81 Partnoy F. *The Siskel and Ebert of Financial Markets?* (n.9) 627.

82 Coffee Jr. J.C. *Ratings Reform: the Good, the Bad, and the Ugly,* 1 Harvard Business Law Review 231, 234 (2011) <http://www.hblr.org/wp-content/uploads/2014/09/Ratings-Reform.pdf>.

83 Becker B. and T. Milbourn, *Reputation and Competition: Evidence from the Credit Rating Industry,* Working Paper 09–051 (Harvard Business School, Cambridge, MA, 2008).

84 Becker B. and T. Milbourn, *How Did Increased Competition Affect Credit Ratings?* 101(3) Journal of Financial Economics 493–514 (2011). DOI: 10.1016/j.jfineco.2011.03.012.

85 Darbellay A., *Regulating credit rating agencies* (n.1) 217–224.

86 Partnoy F. *The Syskel and Ebert of Financial Markets?* (n.9) 639.

87 McVea H. *Credit Rating Agencies, the Subprime Mortgage Debacle and Global Governance: the EU Strikes Back*, 59(3) International and Comparative Law Quarterly 701, 715 (2010) <http://www.jstor.org/stable/40835429>.

Frequently, the most important source of information about the creditworthiness of an issuer comes, in fact, from the issuer itself. Under such circumstances, certified CRAs have more interest in helping issuers benefit from favourable regulatory treatment than in providing investors with accurate information. In light of this, a mandatory conversion to an investor-pays model has been proposed, in which rating agencies would earn fees from users of the rating information.[88] The idea is not new. The major rating agencies relied on subscription fees as their primary source of revenue for most of their history until the early 1980s. In the US, a few registered rating agencies currently operate on an investor-pays model, but they have failed to gain market acceptance and thus remain limited to geographic or product niches. This approach may be a welcome solution, although it would probably result in substantially fewer offerings receiving ratings, to the detriment of smaller and less liquid issuers. Further, critics of this model also suggest that it would not eliminate conflicts of interest but simply shift them from issuers to investors.[89] For these reasons, the US Dodd-Frank Act, although affirming that the credit rating market should be competitive, does not cite competition as a specific objective, and it is improbable that in the US the number of authorized credit agencies will increase in the near future.[90]

A large part of all implemented regulations has been dedicated to reducing the conflicts of interest in which CRAs often operate. In this sense the Russian regulation on CRAs does not differ from the others. CRAs are obliged to submit all rating information to a financial supervisor, which will make it publicly available for users. The financial supervisor will monitor CRA activities and hold the power to suspend or revoke the registration of any rating agency found to be in breach of these rules. In Russia the duty to collect information and supervise on ratings is given to the CBR; in the EU it is the European Securities and Markets Authority (ESMA) and in the US it is the Securities and Exchange Commission (SEC). Like US and EU regulation, Russian rules on CRAs increase the level of disclosure required of this market as the availability of relevant financial information may have a positive implication for the competitive environment in the rating industry. In the US for instance, the SEC, independently of the mandates enacted under Dodd-Frank, introduced rule 240.17g-5, which required, among other things, that sponsors of securitization

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88 SIFMA (Securities Industry and Financial Markets Association), *Recommendations of the Credit Rating Agency Task Force (*2008) <http://www.sifma.org/issues/item.aspx?id=21391>.

89 Goodhart C.A.E. *The regulatory response to the financial crisis,* 13, 130; Goodhart C.A.E. *How, if at all, should Credit Rating Agencies (CRAs) be regulated?* 181, 1–34 (LSE Financial Market Group Paper Series, June 2008).

90 At today, there are 10 rating organizations authorized by NRSRO in the USA against 26 registered rating agencies in the EU. In the US States from 2008 to 2014 the market shares of the big three rating agencies Standard & Poor's, Moody's and Fitch has passed from more than 99 to 96.6 per cent, *see* Staff of the SEC, *NRSRO Annual Report 2014* 11; Staff of the SEC, *Summary Report of Commission Staff's Examination of Each Nationally Recognized Statistical Rating Organization, As Required by Section 15E(p) (3)(C) of the Securities Exchange Act of 1934* 4 *(December 2015)*.

transactions seeking ratings from CRAs create a password-protected website to which they must post all documents and data to be considered by the agency when issuing a rating.[91] Under this rule, access to this website must be given to all qualified CRAs not requested to provide a rating for a particular transaction together with any additional information communicated from issuer to invited agency, whether orally or in writing. In this way, access to confidential information from issuers, which is facilitated for the major rating agency, does not constitute an unfair advantage over providers of creditworthiness assessments based on public information. The goal of this rule was to incentivize uninvited agencies to issue unsolicited ratings on complex hybrid issues – in order to prevent *rating shopping* by issuers.[92] However, in practice, the rule has only imposed new formalities and constraints on the communications between issuers and rating agencies, with no rating agencies willing to invest the resources necessary to provide a rating without being paid for it.[93]

The SEC also introduced rules regarding the internal-control structure at rating agencies, which ensures review of the methods used to generate effective ratings. Every year, the managing director of a CRA must deliver and sign a report attesting to the company's internal controls. The rules prohibit anyone involved in sales and marketing to play a role in determining the credit rating. Other disclosure mandates are the obligation for CRAs to publish their methodologies, credit rating histories and additional information for investors.[94] All these requirements have also been introduced in the European and Russian regulations.[95] However, it is recognized that relevant legislation of the Russian government only came about in recent times and, as such, the assessment of this regulation takes place in a limited chronological space.

Where the Russian approach seems so far to diverge is in relation to the civil liability of CRAs. In the US, section 939G of Dodd-Frank rescinded the exemption from liability under section 11 of the Securities Act of 1933, which rating agencies

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91 *Code of Federal Regulations*, Part 240 Rule 17g-1 to 10 (Nationally Recognized Statistical Rating Organizations). The SEC provided several exemptions from many of the requirements introduced by the Rule 17g-5 for small size NRSRSO for which it would be too big burden.

92 U.S. SEC, *Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies* (Washington, DC, 2008) <http://www.sec.gov/news/studies/2008/craexamination070808.pdf >.

93 Borod R.S. and M. Bartlam, *Rating Agency Reform in the EU and the U.S.*, 38(13) Practical International Corporate Financial Strategies 3–4 (2012) <http://files.dlapiper.com/files/upload/DLAPiper_CF07152012.pdf>. A more draconian tool was proposed in the Franken Amendment to Dodd-Frank Act. The Amendment required the SEC to study 'the feasibility of establishing a system in which a public or private utility or a self-regulatory organization assigns nationally recognized statistical rating organizations to determine the credit ratings of structured finance products' ($ 939F). However, it got watered down in the final version of Dodd-Frank.

94 *Code of Federal Regulation*, Part 240, section 17g-7.

95 For Europe see CRA I regulation 2009 articles 8, 9, 10, 11, 12 and Annex I, Section E, Pt II. For Russia, see CRA regulation 2015 No 222 FZ articles 3 to 14.

previously enjoyed under Rule 436(g). CRAs were largely immune from liability and seemingly did not owe any duty of care to investors. It has been very difficult to demonstrate the reliance necessary to be successful in a fraud or negligence action against a CRA.[96] After this amendment CRAs became exposed to liability for misconduct like other gatekeepers such as accounting firms or securities analysts.[97] This rule was complemented by the introduction of article 933(b)(2), which alters the pleasing standards applied to actions against rating agencies. Accordingly, plaintiffs will have grounds to sue CRAs in court if they can allege that 'the rating agency (i) knowingly or recklessly failed to conduct a reasonable investigation of the facts on which it relied in evaluating the credit risk of the securities, and (ii) it failed to obtain reasonable investigation on those facts'.[98] The rule in practice requires rating agencies to act more independently in examining and verifying the facts on which they rely and to obtain independent verification of material facts. Only time will tell.[99] A similar approach was taken in Europe where art. 35(a) of Regulation 462/2013 established a liability regime for CRAs, especially in circumstances where the absence of a contractual relationship would make it difficult to impose a civil liability.[100] Despite these clear approaches towards the introduction of civil liability for CRAs, the Russian regulator so far has decided not to include any provision in this sense.

Another difference in the approach to regulate CRAs that distinguishes Russian and European regulation from the US Dodd-Frank Act concerns the problem of rating involvement in banking capital regulation. Rating-based regulation had the result of creating market over-reliance on CRAs, which facilitated bad practices that compromised the integrity of their ratings.[101] It has been said that rating-based regulation discourages investors from performing their own due diligence.[102] As the IOSCO concluded in its report in 2008, banks should not be allowed to outsource their risk management to CRAs, and they should by no means try to escape from their

96 *Jefferson County Sch. Dist v Moody's Investor services, Inc* [1999], No 97-1157; *Compuware Corp v Moody's Investor services, Inc* [2007] No. 05-1851; Newby v Enron Corporation [2005] 511 F Supp 2d 741.

97 Dodd-Frank Act section 933(a). See 15 U.S.C. 78o-7(m)(1).

98 15 U.S.C. 78u-4(b)(2)(B).

99 Miglionico A. *Market failure or regulatory failure? The paradoxical position of credit rating agencies,* 9(2) Capital Markets Law Journal 194–211 (2014). DOI: 10.1093/cmlj/kmu001; Ellis N.S., L.M. Fairchild and F. D'Souza, *Is Imposing Liability on Credit Rating Agencies a Good Idea? Credit Rating Agency Reform in the Aftermath of the Global Financial Crisis*, 17(2) Stanford Journal of Law, Business & Finance 183–184 (2012).

100 See CRA III, Tittle IIIA *Civil liability of Credit Rating Agencies* (2013).

101 Partnoy F. *Overdependence on credit ratings was a primary cause of the crisis,* 27 Fondazione Eni Enrico Mattei Nota di Lavoro (2009) <http://hdl.handle.net/10419/53327>.

102 FSF, *Report of the FSF on Enhancing Market and Institutional Resilience* 37–38 (April 2008); IOSCO, *Report of the Task Force on the Subprime Crisis*, *Final Report* 39 (May 2008) <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD273.pdf>.

legal obligations. Therefore, ratings should not be given a 'regulatory license' relative to other forms of financial risk assessment.[103] This has been the approach taken by the US regulator. Accordingly, the objective of the Dodd-Frank Act of 2010 was to remove certified CRAs' quasi-governmental function and to reconsider them as exclusively private-sector entities.[104] However, this does not so far seem to be the approach of the EU. The EU regulation on CRAs amended in 2011 (CRA II) included hedge funds among the issuers required to use ratings issued by registered or certified rating agencies. The Russian regulator has not dealt with this issue yet.

6. Conclusion

The effectiveness and efficiency of CRA regulations introduced in the EU and US have been widely criticized by doctrine and institutional bodies. It was argued that such reforms were insufficient and merely treated the symptoms of the problems and not the root causes because they left unchanged the fundamental characteristics of the rating industry, namely the issuer-pays business model and the rating-based regulation.[105] For these reasons, further regulation was introduced. Only time will tell how effective this is. Both regulators have concentrated their efforts on educating investors on the limitations of ratings. However, while civil liability for the authorized agencies operating in the market was introduced in both regulations, the US has taken a more energetic approach in eliminating references to rating in banking and financial regulation.[106]

So far the Russian regulator has implemented adequate rules to reduce the conflicts of interest and increase competition in the industry in line with the other regulations on CRAs. However, the achievement of these goals implies the implementation of wider competition policies aimed at providing market players with the right incentives. Only adequate incentives can make CRAs compete on

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103 IOSCO, *The Role of Credit Rating Agencies in Structured Finance Markets*, *Final Report* 2 (2008) <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD270.pdf>.

104 Dodd-Frank Act section 939(a-f) has expressly removed statutory references to ratings. Pursuant sec. 939A every Federal Agency has one year to remove regulatory reliance on ratings, which will have to be removed from every type of governmental rule.

105 See Amtenbrink F. and J. De Haan, *Regulating Credit Ratings in the European Union* (n.1) 1943 ff; Mollers T.M.J. *Regulating Credit Rating Agencies: the new US and EU law – important steps or much ado about nothing?* 4(4) *Capital Markets Law Journal* 496 (2009). DOI: 10.1093/cmlj/kmp034; Weber R.H. and A. Darbellay, (n.3) 10 ff.; Veron N. *Rating Agencies: An Information Privilege Whose Time Has Passed,* Briefing Paper for the European Parliament's ECON Committee (Bruegel Policy Contribution 2009/01) at <http://veron.typepad.com/>; It is also interesting the proposal of professor Goodhart in favour of an independent institution, a CRA Assessment Centre, whose only task would be to assess the accuracy of CRA estimates and to publish comparative studies of such accuracy. Thus no further legal intervention would be needed. See Goodhart C.A.E. *The regulatory response to the financial crisis* (n.13) 129 ff.

106 Alexander Kern, *The Risk of Ratings in Bank Capital Regulation* (n.13) p. 312.

rating quality. Russia favoured the increase of the number of rating agencies and recently welcomed a multilateral independent international credit rating agency called UCRG (Universal Credit Rating Group) resulting from a partnership between China's Dagong Global Credit Rating, US-based Egan-Jones Rating Company and Russia's RusRating. The next step could be to introduce civil liability of CRAs for misconduct following the example of the other regulations. However, as evinced in this article, CRAs' failures were especially structural. Being a potentially high-growth economy, Russia presents a great market for CRAs, which have largely increased their profits in a very few years. Likewise, the Russian economy needs CRAs in order to raise foreigner funds to develop its market. The next challenge for the Russian regulator will be to favour the role of CRAs in the market while increasing their supervision. This objective could be achieved through empowering a unit of experts dedicated to CRAs within the Central Bank that will supervise CRAs and examine the functioning of their boards and deliberations, as for example in Europe, by facilitating interactions between the unit and CRAs' independent non-executive directors.

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