SciencesPo
CENTRE D'ÉTUDES EUROPÉENNES

LES CAHIERS EUROPÉENS DE SCIENCES PO

> N°04/2015

Business as unusual: Credit rating agencies' lobbying success during the EU financial crisis

> Vlad Gross

Les Cahiers européens de Sciences Po

N° 04/2015

December 2015

Vlad Gross

Business as unusual:

Credit rating agencies' lobbying success during the EU financial crisis

Vlad Gross is a researcher at the Antwerp Centre for Institutions and Multi-Level Politics. His research concentrates on interest group representation in the European Union. Most recently he co-authored "Biased access? Exploring selection to advisory committees" in *European Political Science Review*, Vol. 7, Issue 3, 2015.

Vlad Gross est chercheur au Antwerp Centre for Institutions and Multi-Level Politics. Son travail porte sur la représentation des groups d'intérêt dans l'Union Européenne. Plus récemment il a coécrit "Biased access? Exploring selection to advisory committees" dans *European Political Science Review*, Vol. 7, Issue 3, 2015.

Contact: gross.vlad@gmail.com

Citation: Vlad Gross (2015), "Business as unusual: Credit rating agencies' lobbying success during the EU financial crisis", *Les Cahiers européens de Sciences Po*, n°4, Paris: Centre d'études européennes at Sciences Po.

Abstract:

This study aims to explain the variation in lobbying success among the participants in the consultation on credit rating agencies' regulation in the European Commission. The independence and quality of credit ratings has long been questioned, not only because of the possible conflicts of interest in what is largely a "private business", but also because of the failure of the rating industry to anticipate the default of important financial enterprises. Prompted by the economic crisis that started in 2008, the regulatory framework on credit ratings was a new initiative in the financial sector. The empirical analysis shows that public interest groups were the winners in this process. Factors related to the policy context and the attitudes of key policy-makers had an important effect on determining the winners and the losers in this case.

Keywords: interest groups; European Commission; credit rating agencies.

Résumé:

Cette étude cherche à expliquer l'influence des groupes d'intérêts dans le cas du règlement des agences de notation suite à la crise financière de 2008. L'Indépendance et la qualité des notations ont été toujours mis en question, non pas seulement à cause des multiples conflits d'intérêts dans un système qui est largement privé, mais aussi parce que l'industrie des agences de notation a failli à signaler le défaut de quelques grandes entreprises financières. Le règlement sur les agences de notation a été déclenché par la crise économique dans un contexte où l'activité de ces agences n'était pas auparavant règlementée. L'analyse empirique montre que les groupes d'intérêt représentant le public en général ont été les gagneurs du débat politique autour de cette question. Le contexte politique de la crise et le positionnement des acteurs politiques clé ont eu un effet très important sur le gagneur/perdant de cette réglementation au niveau de la Commission européenne.

Mots clé: groupes d'intérêts ; Commission européenne ; agences de notation

Introduction

Financial regulation and internal market policies have received little attention from scholars studying interest group influence in the EU (Bunea and Baumgartner 2014). Yet, the adoption of a single currency by more than half of the member states has turned, the financial sector into an important field of EU policy-making. On the one hand, given the centrality of economic and financial policy at the EU level, the regulation of credit rating agencies (CRAs) might not appear in any way special, compared to other financial regulations. On the other hand, the political and economic context of the latest financial crisis offers a good opportunity to observe and explain lobbying success (or the lack thereof) on financial issues.

This study examines the lobbying success of various interest groups in the EU Commission regulation of credit rating agencies. The independence and reliability of credit ratings has always been a contentious issue (see- Cantor and Packer 1994, Flandreau et al. 2011), making the regulation of CRAs all the more difficult. However, policymakers became seriously concerned with the role and quality of ratings after it became clear that rating agencies bore major responsibility for the 2008 financial crisis. More precisely, the high investment grades given to securities backed by subprime mortgages not only aggravated the crisis, but also called into question the reliability of credit ratings altogether (Taylor 2008). In the European Union the blame game was followed by a regulatory campaign covering an entire range of financial services. Around 27 major legislative proposals addressing different areas of the financial market were put forth by the European Commission in only two and a half years, beginning in 2010. Three of these legislative proposals addressed the regulation of rating agencies.

Rating agencies' have operated on the basis of reputation and for many years this reputation was upheld (Cantor and Packer 1994). Before 2008, the activity of credit rating agencies was not subject to any industry-specific regulations. However, CRAs played a very controversial role in the rating of important companies that went bankrupt, such as Enron (2001) or Parmalat (2003), and in the rating of US subprime mortgages. They were accused of having intentionally given investment grades to toxic financial instruments. Their rating methodologies were obscure, although the vast majority of financial institutions relied on these ratings for investment and regulatory purposes. Moreover, the global ratings market was dominated by three major companies - Standard & Poor's (S&P), Moody's and Fitch Ratings.

This was the context in which policymakers began debating regulatory proposals aimed to deal with these problems. Rating agencies naturally opposed such regulation due to the increased operational costs involved and the loss of freedom from regulation that few business actors enjoy. But other important businesses also opposed the regulation of CRAs because of the predominant business model they under: the "issuer-pays" model corporations issuing bonds to raise capital pay rating agencies to evaluate their creditworthiness. This model opened the door to major conflicts of interest: a higher price could lead to a higher, though undeserved, rating.

In addition to their controversial role, rating agencies wield unusual structural power in contemporary market economies. The role of CRAs is to produce assessments of the payment default risk related to various financial instruments offered by an issuer or assessments of "the likelihood that an issuer will default [...] on its financial obligations generally" (European Commission 2006). The overall potential of CRAs to affect global financial markets and the consequences of such structural power on a large number of businesses and people go beyond mere economic power (Sinclair 2005, pp. 175-76). Through their evaluation of sovereign debt instruments, rating agencies have a significant impact on national economic policy. Thus, they have indeed acquired an important political role within the state-corporations-employees nexus.

Despite the power that rating agencies can wield, the outcome of the policy consultation on the regulation of CRAs in the EU was unexpected, which is why this case study is important for better understanding EU lobbying success. The interest group mobilization was overwhelmingly in favor of business groups, including CRAs, yet they did not manage to stop the regulation proposal. Furthermore, business interest group demands were left out of the final Commission document and the regulation turned out to be particularly costly for rating agencies.

Interest groups' written contributions to open consultations preceding the policy proposals constitute part of the empirical basis for the lobbying success analysis below. Previous studies have addressed the issue of lobbying success in the EU; by connecting specific policy outcomes to interest group preferences expressed in consultation contributions (Michalowitz 2007, Klüver 2012, Bunea 2013). There is some evidence in the literature that, on average, business groups have higher rates of preference attainment across policy issues (Green-Cowles 1995, Dür and Bièvre 2007, Bunea 2013). For instance, scholars have argued that business groups are more likely to influence trade policy, because they deemed to have a legitimate mandate and less extreme demands, as compared to NGOs (Dür and Bièvre 2007). In other words, it is seen as a given that international trade policy should promote free trade, which is exactly what business groups demand. Meanwhile, NGOs make "extreme demands" such as fair and environmentally sustainable trade, that are more difficult to accept. Another empirical analysis concluded that a policy issue with a more narrow scope should yield greater lobbying success (Mahoney 2008). The scope of an issue is defined as the number of interests it touches upon. For example, the CRA regulation has a narrower scope than regulation on financial transactions. When there are fewer interests to accommodate, lobbying success is more likely. Results from the same study also indicate that the level of conflict should have an inverse effect on lobbying success: the lower the conflict between interest group preferences, the higher lobbying success of each group should be.

However, not all results confirm business dominance in lobbying influence (Klüver 2012, Dür and Mateo 2014, Dür et al. 2015). Why was the policy proposal issued by the Commission less in favor of CRAs and business groups, even though the policy consultation was largely dominated by business interests? About 70% of interest groups participating in the policy consultation were business groups. Additionally, the scope of the issue was relatively narrow. It addressed the activity of a specific business sector, namely CRAs. The level of conflicting interests over the issue was low, if measured in terms of the ratio of actors for and against regulation. Nonetheless, the outcome's various policy characteristics were unexpected. I argue that the outcome of the policy proposal was shaped by the pro-regulation stance of key political actors, the socio-economic context in which it appeared on the legislative agenda and the salience of the policy issue.

I begin with a brief overview of previous empirical studies on lobbying success and formulate a number of expectations regarding the CRA case on the basis of broader theoretical conclusions that these studies suggest. The methodological approach is based on a qualitative analysis that I will outline in the second section. To better understand the outcome of this policy consultation I will then provide an account of the evolution of credit rating regulations in the EU (and to some extent in the US), emphasizing the important place that CRAs occupy in the economy and the increased salience of this topic during the financial crisis in Europe. I then outline the preferences of various actors regarding the regulation of the credit rating sector in order to show the extent to which they were included or excluded from the Commission policy proposal. The last section provides a discussion of the empirical observations before concluding.

Interest groups and lobbying success

Most empirical studies on interest groups emphasize three sets of factors that are likely to shape lobbying success (Mahoney 2004, Baumgartner et al. 2009, Klüver 2011). First, the *institutional context* in which groups try to promote their interests can vary in a number of ways. For instance, in contexts where institutional structures allow more access points to decision-makers or where policymakers are directly elected, interest group success can be higher than in institutional contexts where the opposite is true (Mahoney 2008, pp. 35-44). For instance, in national politics, interest groups can take their pleas to local, regional or national authorities, as well as different deliberative forums at each of these levels (local councils, mayors, regional councils and governors, national parliaments, cabinets and agencies, etc.). At the same time, electoral politics change lobbying because interest groups can get involved into electoral campaigns by mobilizing grassroots movements and making substantial financial contributions. These factors are largely absent at the EU Commission level.

Second, concerning *policy issue* characteristics, the same empirical studies show that narrow interests are less likely to translate into policy outcomes when the scope (the number and diversity of those affected by the policy) of the issue is larger, when public attention is higher or when policy actions are triggered by an exceptional event. Previous research on lobbying suggests that the context in which policy-making takes place can be crucial for lobbying success (Lowery et al. 2008), but such contextual factors do not only change in a "static" fashion, from one issue to another, but also in a more dynamic way, across time. It is well known that the 2007-2008 financial crisis spurred major public debate on economic policy in many countries. The same policy issue can be framed differently depending on events that transcend the scope of the issue itself. In the case of the CRA proposal, the context of economic crisis shifted the policy narrative in favor of more regulation. This is because lack of regulation was generally perceived as one of the reasons why the crisis occurred. Complex financial instruments that were so new that they had not been regulated in any way have often been cited as the vehicle of the 2008 financial crisis. While large-N studies have their obvious benefits, they often fail to capture such contextual factors because the nature of currently available data does not account for important political and economic changes across time, such as the occurrence of an economic crisis. The concept of "focusing event" introduced by Kingdon (1995) clearly illustrates this argument: an exceptional event (such as the emblematic meltdown of the US investment bank, Lehman Brothers) can have an important impact on the perception and framing of a policy issue and, consequently, on lobbying success.

By focusing on a single case study, institutional and policy issue variation are held constant in this study. Through this approach, I am able to isolate certain explanatory factors and discard others. In the empirical analysis I discuss the relevant institutional and policy characteristics specific to this case. At this stage it is important to mention that institutionally, DG Internal Market was in charge of the proposal, more specifically, Unit F4, which is responsible for credit rating agencies. The policy consultation was characterized by a low level of conflict between stakeholders. The Commission received 74 contributions for the 2008 consultation and 78 contributions for the 2010 consultation. These figures are close to the average number of 87 submissions that the Commission generally receives for a consultation (Klüver 2013). Nonetheless, the proposal was characterized by a low degree of conflict among interest groups because a vast majority of stakeholders were on the same side, opposing most of the issues raised by the Commission consultation.

I will therefore concentrate on a third set of factors that can affect lobbying success – *interest group level characteristics* - such as the nature of the interest represented. The focus on this variable is driven by the core question in interest group research (Klüver 2013, p. 1): do business interests systematically influence the policy-making process? The question of lobbying success has important normative implications: if there is indeed a systematic bias in policy influence, it means that policy goods are unequally distributed in society, underminning general principles of good governance and having major consequences for political output legitimacy (Scharpf 1999, Zürn 2000). Previous research findings indicate that we still do not know very clearly how interest groups manage to influence EU policies or which types of interest groups have more influence (Egdell and Thomson 1999, Dür and Bièvre 2007, Mahoney 2008, Bunea 2013, Klüver 2013, Dür and Mateo 2014, Dür, Bernhagen et al. 2015). Sometimes business groups win and sometimes they lose. When policy conflict is high and interest groups face important opposition, they are less likely to be successful in obtaining their policy preference (Mahoney 2004). In the CRA regulation case, business groups were dominant and did not face important opposition. From this perspective, we could expect business groups to obtain what they lobbied for. However, the policy salience and the Commission officials' preferences are additional factors that must be considered. In light of these factors, we could expect business groups to fail in their lobbying efforts, due to increased public attention to financial regulation and policy-makers's views on this topic.

Methods and data

The prevailing method of measuring lobbying success is preference attainment: the researcher observes interest group preferences before a decision is adopted and assesses the extent to which these preferences are taken into account in the adopted decision. Through a detailed overview of all the relevant actors' preferences - including those of the decision-makers - and of the policy context in which the policy decision is taken, we can develop a qualitative assessment of lobbying success.

This method, essentially based on process tracing, is well described by Collier (2011):

> It can [...] be productive to start with a good narrative or with a timeline that lists the sequence of events. One can then explore the causal ideas embedded in the narratives, consider the kinds of evidence that may confirm or disconfirm these ideas, and identify the tests appropriate for evaluating this evidence.

The analysis presented here follows these guidelines. In the next section I provide a timeline of the events that were conducive to the regulation of the CRAs in the EU. These events are not simply described, but they are also evaluated from the perspective of the comments and remarks made by Commission officials, thus improving our understanding of the policy actions taken in relation to these events. I will thus highlight how the policy stance of the Commission towards credit rating agencies was decisively shaped by the Enron and Parmalat bankruptcy scandals, the US subprime mortgage crisis, the 2008 banking crisis and the recent sovereign debt crisis in the EU.

Lobbying success is operationalized as interest group preference attainment with regard to the Commission's legislative proposal to the European Council of Ministers and the European Parliament. In the first phase of the stakeholder consultation process, the Commission outlines the issues that need to be addressed by the proposal, in order to establish a regulatory framework (in this case, on the functioning of credit rating agencies). These issues are outlined in a document containing an explanatory note and the draft legislative proposal that is submitted for consultation. This initial document serves as the basis for the policy debate and stakeholders are largely limited to commenting on the issues proposed by the Commission. However, they are free to raise other concerns in their written contributions to the consultation. In order to evaluate whether interest groups were successful in having their preferences included in the final Commission proposal, I first established the number of regulatory issues that the Commission consultation document proposed by reading the initial Commission consultation document.

In the first CRA proposal of 2008 stakeholders were given the opportunity to comment on seven substantive regulatory issues the Commission sought to address: the supervision of rating agencies by national or EU-level authorities, the authorization of rating agencies by national or EU-level authorities, the over-reliance on credit ratings, the conflicts of interest that occur in the rating process, measures to improve the quality of credit ratings, measures to improve rating transparency, and the choice between a directive or a regulation to address all these issues. The Commission also outlined possible measures on each issue. First, supervision and authorization exclusively by EU authorities meant that CRAs would benefit from reduced compliance costs under a "one-stop-shop" system. The alternative was for national regulators register and supervise them. The choice between the two did not affect the rules with CRAs had to comply, because the regulation would apply in the same way to all national member states. Second, to reduce over-reliance on ratings, the Commission wished to separate the ratings of more complex financial instruments from simple ones, and to encourage internal risk evaluations. Third, to avoid conflicts of interest, the proposal contained corporate governance provisions such as a the separation between the analytical and business departments of CRAs. Fourth, to improve the quality of ratings the proposal stipulated that "health warnings" could be added to qualify the soundness of the information behind them. Fifth, to improve transparency, the Commission wanted CRAs to publish their methodologies and give more information about how they produced a given rating. Finally, a regulation would not allow for any flexibility regarding its effects, whereas a directive would have to be transposed into national law by member states.

The second Commission proposal of 2011 addressed the following five issues, restating some initiatives from the first consultation: the over-reliance on credit ratings, specific rules for sovereign ratings that would be distinct from private ratings, measures to improve competition in the rating industry, civil liability procedures applicable to rating agencies in the event of loss incurred from incorrect ratings, and the possible replacement of the issuer-pays model with another type of rating payment system. The debate, revolved around the specific measures addressing these issues. First, to reduce over-reliance on ratings, the Commission proposed again the development of internal risk evaluations, but also reconsidered references to ratings in other regulatory frameworks, such as the CRD Directive. Second, stricter methodological procedures and timelines were proposed for sovereign debt ratings. Third, the Commission thought it could encourage competition by allowing the European Central Bank or national banks to publish ratings and, perhaps, by setting up a public rating agency. Fourth, the amended regulation aimed to introduce civil liability (legal responsibility) for rating misdemeanors. Finally, the proposal suggested the replacement of the issuer-pays model with an investor-pays model or other alternatives.

To establish the preferences of interest groups on these issues I drew on the information provided in their written contributions. Additionally, my description of the European Commission's initial policy position is based on the consultation explanatory document issued by the Commission and various public statements made by Commissioner Michel Barnier and Commission President José. To evaluate whether interest groups managed to successfully influence decision-making, I then describe the extent to which the Commission changed its position in the final proposal regarding the issues on which interest groups could comment.

Type of interest	Frequency	Percentage
Business	107	70.39
National authorities	29	19.07
Occupational groups	7	4.60
Trade unions	5	3.28
Public interests	4	2.63
Total	152	100

Table 1. Interest group types

We can first observe that, on the one hand, the distribution of interest group types participating in the consultations is skewed in favor of business interest groups. Table 1 shows that 70.39 percent represent business interests, followed by national authorities (19.07 percent), occupational interests (4.60 percent), trade unions (3.28 percent) and public interests (2.63 percent). On the other hand, the distribution is more diverse and balanced in terms of the organizational form of the groups represented (Table 2): almost 30 percent are, respectively, national membership associations and non-membership groups (such as companies and think-tanks), 21.71 percent are EU and international membership associations and 19.07 percent are national authorities.

Organizational form	Frequency	Percentage
National associations	45	29.60
Non-membership groups	45	29.60
EU and international	33	21.71
National authorities	29	19.07
Total	152	100

Table 2. Interest groups organizational forms

This approach also obviously has its limitations. It is a subjective evaluation on the basis of key public documents and statements issued by interest groups and European Commission officials. However, it is also a transparent approach, since the observations from which inferences are drawn are publicly available to those wishing to replicate the analysis. This approach only takes into account the Commission's ignoring a number of other possible views in the EU Parliament. While the latter views are certainly important, the focus of this study is to explain interest group influence on Commission proposals.

The development of credit rating agency regulation

The practice of systematic credit rating is new in the history of financial markets. The first agencies were established at the beginning of the 20th century, mostly in the United States (Alcubilla and Del Pozo 2012). In 1909 Moody's began to publish the first bond ratings, and was soon followed in that business niche by the Poor company, which merged with Standard Statistics in 1941 to form Standard & Poor's (S&P). Before the 1990s, when Fitch Ratings emerged as a strong competitor, Moody's and S&P formed an effective duopoly in the credit rating market. Other important rating agencies were established over the years - e.g. the Canadian company DBRS in 1976, the Japanese company Japan Credit Rating in 1985, the German company Assekurata Ratings in 1996 - but they never managed to break the oligopoly formed by "the big three". With the development of a global financial market the biggest agencies have become multinational corporations (Cantor and Packer 1994). According to various reports, in 2008 Moody's, S&P and Fitch dominated the global credit rating business with a combined market share of about 95% (Langohr and Langohr 2008, Portes 2008, Scalet and Kelly 2012).

Until recently, the rating industry lacked any legally binding rules regarding their activity, in Europe as much or anywhere else. The reason was that rating agencies were considered to be issuers of mere "opinions" that informed market actors - which under

US law was protected by the First Amendment - and many judges upheld this notion in court when rating agencies were brought to trial (Partnoy 2006, p. 62). This legally laced put ratings on par with the bond yields information page in *The Wall Street Journal*. In fact, the paradox noted by some observers of CRAs was that ratings did not add any marginal value to the interest yield information an investor might rely on when investing in a sovereign or corporate bond (Wakeman 1981, Sylla 2002, Partnoy 2006). What use was there, then, for rating agencies? The answer is that ratings were perceived as "quality labels" attesting that issuers were respecting financial regulations and not merely as indicators for investment (Partnoy 2006, p. 78).

The lack of regulation despite the growing role of CRAs in financial markets and a number of financial scandals involving CRAs. In the United States rating agencies were accused of failing to signal the biggest bankruptcy in the country's history, namely that of the energy company Enron. Only four days before Enron filed for bankruptcy on December 1, 2001, the three biggest CRAs - Moody's, S\&P and Fitch - rated the company "investment grade" (Coskun 2008). The company was therefore able to continue raising capital by issuing debt, although it was struggling with financial problems long before that point. Most notably, in early October, 2001, Enron had informed credit rating agencies of a 2.2-billion- dollar reduction in the value of its assets, and one month later the company drew down a line of credit totaling to 3 billion dollars held with its banks. Rating agencies decided to keep Enron's "investment grade", despite being aware of suspicious accounting practices at the company. The rating agencies defended themselves by arguing that the "investment grade rating" was maintained because Enron had a potential buyer - the energy company Dynegy - that would have presumably ended its financial difficulties. The merger, however, was never completed. One report from the US Senate Committee for Governmental Affairs, which investigated the scandal, indicated that the rating agencies carried an important responsibility for the losses of many investors in Enron and the final collapse of the company. The report stated that the rating agencies' "monitoring and review of [Enron's] finances fell far below the careful efforts one would have expected from organizations whose ratings hold so much importance" (United States Senate 2002). The report provides details on problems surrounding the rating agencies' activities in relation to Enron: insufficient review of the materials provided to CRAs by the company, a short term view of its creditworthiness based on the faint promise of a merger with Dynegy, a lack of inquisitiveness regarding the company's accounts, and most importantly the lack of accountability for any wrongdoing in the rating of the company. Indeed, it took the collapse of a market giant like Enron for the US Congress to step up the debate about a regulatory framework for CRAs and adopt the first legislative package ever to deal with the practices of these firms - the CRA Reform Act in 2006 (Coskun 2008, Sy 2009).

In Europe, CRA regulation followed a peculiar path before the Commission proposed to reform this sector in 2008. The European Parliament monitored "with interest the critical appraisal of the activities of the rating agencies undertaken by the United States authorities, especially as occasioned by the bankruptcy of the Enron corporation" (European Parliament 2004). On November 24, 2003, the European Parliament organized a hearing on the role and methods of rating agencies. The following entities participated in the hearing: Goldman Sachs, Gimar Finance & Cie, Moody's, KPN, Axa

Investment, the Organisation for Economic Co-operation and Development (OECD), Allianz A.G., Fitch Ratings, the Chairman of the Hellenic Capital Market Commission and Standard & Poor's. Referring to this meeting, an EU Parliament resolution published almost three months later noted the following:

> "every witness giving testimony at Parliament's public hearing on 24 November 2003, except the representative of a public regulator, testified that regulation was unnecessary and could be counter-productive. However, the witnesses invited by Parliament did not constitute a statistically-controlled, random and unbiased sample of market participants; in addition, some of the witnesses may have been swayed by the great influence exercised over market opinion by the [rating] agencies themselves".

One month after this hearing, the bankruptcy of the Italian food company Parmalat reignited the policy debate on CRAs in Europe. Parmalat was rated "investment grade" by S&P up until one and a half weeks before it filed for the biggest bankruptcy in Europe, with a 14-billion-euro deficit in its accounts (B. B. C. News 2008). According to the press, the Italian finance minister at the time, Giulio Tremonti, called it "Europe's Enron" (Hooper and Milner 2003). The European Parliament passed a specific resolution on the Parmalat case in February, 2004, where it noted that "the recent financial scandals in Europe and the United States underline the crucial role of auditing firms" and expressed concern that rating agencies did not have the "slightest suspicion, at any stage in the audit process, that funds were being embezzled" (European Parliament 2004).

In the aftermath of the Enron and the Parmalat financial fraud scandals and the ensuing public debates over the responsibility of rating agencies (Ducourtieux and Michel 2004), the EU Parliament asked the EU Commission on 10 February, 2004, to seek advice from the Committee of European Securities Regulators (CESR)[1] on possible CRAs legislation (European Parliament 2004). The Commission sent an official demand for technical assistance to the CESR on 27 July, 2004 (European Commission 2004) the first of April, 2005. The CESR organized two consultations and a hearing with market stakeholders and issued an opinion to the Commission in March, 2005. In its response, the CESR advised against any regulatory measures, as they might increase entry barriers for new CRAs. The CESR was "of the opinion that, overall, the substance of the IOSCO Code is the right answer to the issues raised by the Commission" (CESR 2005). The International Organization of Securities Commissions (IOSCO) brings together governmental agencies responsible for enforcing financial market legislation. IOSCO set up a code of conduct for CRAs, but it was, voluntary. In other words, no matter how stringent the IOSCO Code was, rating agencies could not be held accountable if they did not follow its principles. It is beyond the scope of this study to analyze the CESR

[1] CESR became the European Securities and Markets Authority (ESMA), an agency created by the European Commission in 2011. Together with the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA), ESMA functions as a regulator and supervisor of EU financial services.

recommendation, but the close resemblance between its policy position in 2004 and that of the major CRAs certainly merits further analysis.

In its report to the Parliament, the Commission followed the CESR recommendation and concluded that regulation of credit rating activities was not necessary (European Commission 2006). The argument behind this decision was that certain standards for credit rating were already in place through the IOSCO code of conduct and certain provisions in three other directives: the Market Abuse Directive (Directive 2003/6/EC, also known as the MAD Directive), the Capital Requirements Directives (Directive 2006/48/EC and Directive 2006/49/EC, also known as the CRD Directives) and the Markets in Financial Instruments Directive (Directive 2004/39/EC, also known as the MiFID Directive). A closer look at these normative texts reveals that they were utterly inadequate for tackling the problems of the credit rating industry. The IOSCO Code was useless by virtue of both its voluntary character and its very general principles: CRAs should publish high-quality ratings, they should monitor and update their own past ratings, they "should comply with all applicable laws and regulations governing [their] activities in each jurisdiction in which [they] operate", they should separate their rating activity from other business activities, they should be transparent about their methodologies and publish their ratings in a "timely manner" (CESR 2005). The MAD Directive and the MiFID Directive did not even contain the terms "credit rating". The CRD Directive contained the term twice in the same paragraph, to mention that there is no formal authorization for credit rating agencies in the EU.

Nonetheless, the Commission tasked the CESR with reporting back, on an annually, on the compliance of rating agencies with the IOSCO code. In its first annual report, the CESR concluded that CRAs "comply to a large extent with the IOSCO Code", but that "there is room for improvement" in certain areas, promising to follow up in its next report on whether these improvements were made (CESR 2006). After 2007, when the subprime mortgage crisis hit the US financial markets, CESR reports began to show some concern about credit rating transparency, but still maintainied that regulatory intervention was not necessary. The second report on the rating agencies' compliance with the voluntary code of conduct advised the Commission to create a monitoring body that would include rating agencies in order to insure a better functioning of the industry. The report suggested that if this monitoring body failed in its task, the authorities "should step in to ensure, probably through regulation, the integrity and quality of the rating process" (CESR 2008). The report further noted that "there is no evidence that regulation of the credit rating industry would have had an effect on the issues which emerged with ratings of US subprime backed securities and hence continues to support market driven improvement" (CESR 2008). The last report, published in May 2009, was more critical of the normative framework that guided the activity of CRAs. The report simply evaluated the compliance of CRAs' code of conduct with the IOSCO Code. It found that many EU CRAs did not have a code of conduct to begin with and that those which did deviated from the principles of the IOSCO Code n some respects (CESR 2009).

The contextual effect of the financial crisis that began in 2007 with the subprime mortgage crisis in the US was an important catalyst for initiating the regulation of CRAs as well as that of other sectors of the financial industry. During August, 2008, the

Commission organized an open consultation on a possible legislative proposal regarding CRAs. Upon the launch of the consultation, the Commissioner for Internal Market and Services, Charles McCreevy, made the following statement in a press release on July 31, 2008 (European Commission 2008):

> I have been listening to many advisory bodies to the Commission and watching developments in the industry and in other jurisdictions for the last year. I am convinced, like others in Europe of the need to legislate in this area at EU level. CRAs will have to comply with exacting regulatory requirements to make sure ratings are not tainted by the conflicts of interest inherent to the ratings business. The crisis has shown that self-regulation has not worked. I am also convinced that excessive reliance on ratings in EU legislation might have discouraged banks and other financial institutions from exercising their own due diligence. They should not be encouraged by law to rely solely on ratings for their risk assessment processes. I intend to present my proposals to the Commission for adoption this autumn and I look forward to receiving the views of all interested parties.

The Commission sent a regulation proposal to the Council and the EU Parliament on November 12, 2008. In a press conference organized on this occasion, Commissioner McCreevy described the IOSCO Code as a "toothless tiger", but noted that "credit rating agencies are not alone in carrying some responsibility for the scale of the current financial market problems - they are one of very many elements in the mix" (European Commission 2008). The first CRA proposal was adopted by the EU Parliament and the Council on November 17, 2009. In June 2010, The Commission proposed an amendment to the CRA regulation in order to give ESMA an exclusive supervisory role in the EU, thus strengthening oversight of CRAs. The amendment was adopted by the Council and the EU Parliament in record time, by December, 2010. At the end of that year, a new public consultation was launched to propose additional changes to the first CRA regulation. Following the 2010 consultation, a new proposal was adopted in 2011. The empirical analysis that follows traces the representation of stakeholder preferences in the Commission proposals that were preceded by the public consultations of 2008 and 2010.

Stakeholders' and policymakers' preferences on the CRA regulation proposals

How did various stakeholders react to the Commission's move to introduce regulation on CRAs? The stakeholder consultation contributions provide extensive information that can answer this question[2]. I present the policy positions of the key actors from each

[2] Details about the 2008 consultation and the contribution documents can be consulted at http://ec.europa.eu/internal_market/consultations/2008/securities_agencies_en.htm, last accessed on August 18,

interest group category - business, trade union, occupational, public interests, national authorities - followed by that of the Commission. Unless otherwise specified, quotes are taken from the interest groups' written contributions to the policy consultations.

The overwhelming majority of business groups opposed regulation, regardless of the financial sector they were representing. Among rating agencies, the most representative, due to their market share, were S&P, Moody's and Fitch. S&P expressed "very significant concerns in relation to the proposals and draft legislation" because they "would impose a new set of standards [...] different from those reflected in the IOSCO Code". They considered the IOSCO Code, amended in 2008, to suffice for the purpose of ensuring rating transparency, avoiding conflicts of interest and upholding the quality of the ratings. S&P declared that the "IOSCO Code already offers an appropriate and widely-accepted set of principles and standards for CRAs". Moody's asked the Commission to "consider aligning its position" on many aspects of the proposal with the amended IOSCO Code, and Fitch demanded that "the Proposal should use the language of the IOSCO Fundamentals to the greatest extent possible". However, a close examination of the "revised" IOSCO Code reveals it was almost identical to its 2004 version.

CRAs preferred the IOSCO codes of conduct for two reasons: they were not legally binding and they contained so-called "high-level principles", that is, principles so general that they would be open to interpretation. Indeed, both S&P and Moody's demanded a "principles-based" regulatory system, should the Commission decide to legislate. For a non-specialized expert, such concepts are undoubtedly obscure. Frantz and Instefjord (2014) help explain the difference between "principles-based" and "rules-based" systems:

> principles based systems are specific about regulatory outcomes. The firms must reverse engineer what they need to do to meet these outcomes and document to the regulator how their actions achieve this. There is less ambiguity about the outcomes of regulation than about whether firms' actions actually achieve these. The reverse engineering process is imperfect, therefore, with implications for regulatory failures. In contrast, the rules based systems are specific about what firms must do to comply. The regulator must forward engineer the implications of compliance for the intended regulatory outcomes. There is less ambiguity about the firms' compliance process than with whether regulatory outcomes are met.

In other words, in "principles-based" systems rules are ambiguous and open to interpretation, while in "rules-based" systems they are clear and specific as to what - in our case - rating agencies must do to comply. CRAs therefore, asked the Commission to introduce a less constraining regulatory system.

2015. For similar information regarding the 2010 consultation, see http://ec.europa.eu/internal_market/consultations/2010/cra_en.htm, last accessed on August 18, 2015.

Bond issuing companies - or corporate issuers - were clearly against regulation. European Issuers is the umbrella confederation of publicly listed companies in Europe that regularly issue bonds to raise capital. Its members included companies such as Total, ENEL, Solvay, L'Oréal, BNP Paribas, Unilever or Veolia, as well as business associations from EU member states. According to European Issuers, their combined market value was around 8.5 trillion euros in 2008. The business confederation had doubts about whether "the proposals [...] made by the Commission are appropriate in terms of both substance and form". One of the main concerns of European Issuers was that "if the proposed regulation would considerably raise the costs for CRAs, these costs - due to the oligopolistic market structure - would likely be transferred also to corporate issuers who do not issue complex structured instruments. Clearly this would not be in their interest".

The banking sector voiced the same preference for a "light" approach as CRAs. For instance, the German Banking Associations argued that "[i]t is first and foremost up to credit rating agencies themselves to eliminate [the] shortcomings" exposed by the "financial turmoil since summer 2007". The French Banking Federation was somewhat supportive of the evolution of the IOSCO Code, but considered that "any new regulatory approach should follow a principle-based approach". The Italian bank Intesa Sanpaolo expressed their "discomfort with the fact that the Commission seems to undertake this initiative neglecting [...] possible alternative policy options (e.g. self-regulation, revision of the CRD [Directive], sector directive/regulation)". The bank's opinion was that IOSCO was the most appropriate forum for regulatory decisions about CRAs to be taken. The European Banking Federation was "not convinced" that the regulatory approach of the Commission was "the most appropriate and efficient" and, like many other interest groups, expressed discontent with the fact that the Commission did not allow for more consultation time.

To be sure, the limited time for consultation and the decision to conduct out the consultation during the month of August, at the height of the summer break, was considered inadequate by many business actors - e.g. Intesa Sanpaolo, European Issuers, the Asociacion de Mercados Financieros of Spain or the Commercial Mortgage Securities Association - to whom it appeared the Commission was attempting to pass the proposal without much debate. The Securities Industry and Financial Markets Association stated in their consultation contribution that:

> it is disappointing that pressure to regulate should cut short a thorough consultation. Precipitate regulatory action produced by extraneous pressure often produces economic distortions, market inefficiencies, and anti-competitive outcomes [...] In this case, the financial services industry has been asked to comment on an extensive regulatory apparatus within four weeks - half the time traditionally allotted [...] CRAs have been the subject of several years of regulatory consultation since the Enron collapse, but that dialogue is of little relevance in the present circumstances. None of the previous consultations envisioned regulation on the scale now proposed, nor gave any indication that such measures were

> contemplated. We wish, therefore, to share our discomfort with the reduction of a bedrock principle of the EU regulatory process [i.e. Better Regulation] to a near formality.

The only trade union participating in the 2008 consultation used particularly strong language supporting regulation. The Confederation of the Nordic Bank, Finance and Insurance Unions, which represents employees in the financial sector, demanded the "end of the current world oligopoly of credit rating agencies" and even the establishment of a public rating agency in Europe. The trade union supported all measures proposed by the Commission to tackle the issues described in its draft proposal.

Two occupational interest groups participating in the 2008 consultation represented corporate treasurers, which is a profession dealing with the management of a company's financial assets - revenues, payments, investments, etc. - similar to the way lawyers deal with a company's legal issues. One interest group - the Council of Bars and Law Societies of Europe (CCBE) - represented the legal profession. The EU corporate treasurers' umbrella organization, the European Associations of Corporate Treasurers, was "surprised that the Commission services' proposals are so extensive" and argued in favor of "[l]imited, principles-based regulation of CRAs" rather than a "detailed, rules-based draft [which] seems to be almost wholly inappropriate". This view was fully shared by the French professional association, the Association Française des Trésoriers d'Entreprise. The CCBE only made remarks on one specific article of the draft CRA Regulation that would grant the regulatory authorities access to any documents, and the rights to carry out on-site inspections and require existing telephone and data traffic records from CRAs. CCBE considered these provisions to violate privacy and human rights laws.

One public interest group participated in the consultation - La Voix Des Emprunts Russes, which represent individual citizens holding unpaid Russian Empire sovereign bonds dating back to the Bolshevik Revolution of 1917. They had a rather peculiar reason for participating in the consultation, but were nonetheless an interest group defending their preference:

> The only means of enforcing payment [on the Russian government] is to prevent the debtor from accessing alternative sources of capital until he has settled existing obligations. This would have been achieved if the Russian Federation had been attributed a default rating [...] But the attribution of investment grade ratings has closed this only exploitable avenue.

As a result of this mistake perpetrated by the CRAs, La Voix Des Emprunts Russes pushed the Commission for even stricter measures on CRAs. The group was certainly an outlier due to its strong regulatory demands, but that does not constitute a reason to exclude it from this analysis.

Public authorities in member states disagreed on the appropriate policy measures to be taken. UK authorities were most skeptical about the need for regulation, perhaps unsurprisingly, given the importance of the City of London to the country's economy. The common response from the UK Financial Services Authority, the Treasury and the Bank of England veered more towards the business side. They favored a principles-based approach and advised the Commission not to go further than a "registration regime to ensure effective compliance with the IOSCO Code". Similarly, the Dutch Ministry of Finance argued that the Commission should "avoid rushing headlong into new legislation and setting up a supervisory structure that affects both the industry and the economy as a whole for a long time to come" and that "ensuring quality should take precedence over meeting a self-imposed deadline". The Ministry of Finance of Finland disagreed "that the debate should be started from the premise that the need for such new regulation is so obvious that it does not need to be discussed any further".

However, the French *Autorité des Marchés Financiers* fully supported the initiative "that will complete the European regulatory landscape with an appropriate tool to monitor the activities of the CRAs". Along the same line, the Spanish regulatory agency supported the creation of a "Community Agency for credit rating agencies with full authorization and supervision powers". The Irish Ministry of Finance also supported more constraining regulations, but expressed concerns that such a regulatory structure might unduly give credit ratings a certain official legitimacy.

The position of the European Commission was well reflected in the introductory remarks to the proposal consultation. It explicitly singled out CRAs as bearing an important share of the responsibility for the subprime mortgage crisis, due to their positive rating of the creditworthiness of complex financial instruments that proved to be anything but. The Commission noted that due to the fact that "massive losses have been announced at large institutions and smaller players alike, and as the credit markets are suffering from a prolonged confidence deficit, with likely negative effects on the real economy and risks for financial stability, it has become imperative to address with due care all aspects of this crisis, including the role played by CRAs". Although the member states' positions reflected in the consultation contributions were not fully in agreement with one an other, the Commission stated that the "ECOFIN Council in July 2008 supported the overall objective of introducing a strengthened oversight regime as well as the principle, envisaged by the Commission, that CRAs should be subject to registration in the EU".

The purpose of the 2008 Commission proposal was to restore confidence in the markets in the context of the banking crisis at the time. However, by 2010 the European banking crisis has turned into a sovereign debt crisis (B. B. C. News 2010, Faiola 2010, Oakley 2010). Portugal, Ireland, Greece and Spain (designated by the press with the unfortunate PIGS acronym) were the center of attention, as they faced severe challenges to refinance their public debt in the context of the rapid decline of their sovereign credit rating.

By 2010 the financial crisis, which started with the US subprime mortgages in 2007-2008, was severely affecting European economies. In 2009, the European Union recorded a 4.4% average decline in GDP, according to World Bank data. In this context, the Commission prepared a comprehensive reform of the financial market that included new measures on CRAs. The reform package was presented by the Commission President, the Commissioner for Economic and Monetary Affairs, Olli Rehn, and the Commissioner for Internal Market and Services, Michel Barnier, in a joint press conference on June 2, 2010. President Barroso and Commissioner Barnier took the opportunity to explain their objectives for the CRA regulation and their views on the role of CRAs more generally. The Commission was already determined at that point to rapidly pass comprehensive rules on the functioning of the CRAs market, as stated by Michel Barnier, who also added that:

> We must go further [than what exists on the regulation of CRAs]. Personally, I believe that we must work on a more European rating agency, that sovereign risk must be treated correctly and differently and introduce more competition and transparency on the credit rating agencies market. So, we are ready to go further and we are working on new measures in the coming weeks.

In 2010, the Commission launched a new consultation with the goal of strengthen the existing CRA regulatory structure, especially with regard to sovereign debt rating (European Commission 2010).

Business groups were again opposed to any new regulation. S&P considered this consultation and the prospect of new regulation "premature", given that the first CRA regulation had been introduced only one year earlier. The rating agency also rejected specific measures to enhance competition and was "strongly opposed to any proposed measures to establish a common standard of civil liability". Moody's also noted that the Commission should postpone any new measures, but that if the Commission proceeded with new legislation, it should focus on over-reliance. Moody's was opposed to specific rules for sovereign ratings, the introduction of civil liability and changes the issuer-pays model. Fitch Ratings also argued that "the existing EU Regulation addresses many of the issues raised in the Consultation" and that they "strongly recommend that, prior to initiating a round of amendments to the EU Regulation, the Commission should allow sufficient time to elapse so that all interested market participants can assess the impact of the [existing] EU Regulation". The rating agency also disagreed with the Commission that sovereign ratings are special and did "not think, therefore, that additional requirements need to be added to the EU Regulation to address peculiarities of sovereign credit ratings".

The position of bond issuers was, like in 2008, skeptical about a number of issues raised in the consultation. European Issuers were against the replacement of the issuer-pays model and doubted the usefulness of a civil liability regime for CRAs. Overall, they believed "that the measures designed to prevent another crisis in the financial sector should not impact all corporates; as issuers of corporate bonds companies were not the cause for the crisis and should not be penalised for using the capital markets".

The Association of German Banks (BDB) believed that the regulation should "allow an adequate place for credit ratings" in the financial market, but that "the measures proposed by the Commission services will make it difficult to realise this aim". At the same time, German banks did not believe that "introducing more players into the credit rating market would automatically increase competition and thus enhance the quality of ratings". Regarding sovereign debt ratings, the BDB made the following remark, clearly opposing specific measures on this issue:

> The responses by policymakers to the sovereign downgrades during the euro crisis in spring and summer 2010 clearly

> showed the danger of exercising political influence on financial markets and credit rating agencies. That rating changes influence financial markets is the rule rather than the exception. There are no grounds to assume, however, that the sovereign debt ratings involved in the crisis were in some way flawed and that there is consequently a need for regulatory action. We fundamentally reject the idea of political influence on the timing of changes to sovereign debt ratings.

The French Banking Federation considered existing CRA regulation to be sufficient. It further argued that "credit rating agencies shall not be the scapegoats of the financial crisis", that "ratings published by credit rating agencies are necessary for issuers [...] and for investors". The European Banking Federation responded was along the same lines, adding that many of the measures proposed by the Commission "seem radical, without however improving the well-functioning of Europe's capital markets".
Trade unions supported stronger measures against CRAs. The Austrian Federal Chamber of Labour noted that "[f]rom the spectacular cases of failure one could well draw the conclusion that, where ratings would be helpful, they are wrong, and in the other cases they are unnecessary". The trade union demanded "measures with respect to the fundamental role which ratings can and cannot play in financial markets". The Confederation of the German Trade Unions stated, with regard to the issues tackled by the proposal, that "the arguments from EU-Commission in the consultation paper are very sensible and should be realised".

Occupational interest groups were represented by the same corporate treasurers as in 2009, but also by the Compagnie Nationale des Commissaires aux Comptes (CNCC), the French financial auditors' profession. The European Association of Corporate Treasurers requested that the Commission "refrain from endorsing proposals that may be politically attractive but lack substance in analysis and fact". On the other hand, the French auditors' association endorsed stronger measures on sovereign ratings and less reliance on ratings in financial risk management. However CNCC opposed a civil liability regime for rating agencies.

Public interest groups supported the regulatory measures proposed by the Commission. In addition to the pre-1917 Russian bond holders, another public group was the Centre for Research on Multinational Corporations, a Dutch financial monitoring NGO. Both fully supported measures to increase competition in the CRA market, improve the quality of ratings and impose a civil liability system for CRA negligence.

The disagreeing factions among national authorities did not change significantly with the 2010 consultation, although those opposing more regulation were less vehement in their views. UK and Dutch authorities opposed the creation of a public CRA. They also did not support stricter measures on sovereign debt rating. The prevailing view among UK authorities was that a third revision of CRA regulation was not urgent, but rather "should take full account of the progress that has been secured to date". On the other hand, the French regulatory authorities (AMF) and the Portuguese regulators (CMVM) supported the Commission proposal, particularly its stronger measures on sovereign debt rating.

French and Portuguese support for these measures can be explained by the looming threat of sovereign rating downgrades, which was less threatening in the British and the Dutch cases.

The European Commission moved forward, despite the apparent disagreement among member states. To be sure, there is always a certain level of disagreement among national governments. However, the need for consensus is widely accepted due to the higher costs of "broken institutional relationships" and the damages that "carry over into other, unrelated issues" in the event of a breakdown in negotiations (Thomson et al. 2006). In this case, Commission President, José Barroso noted the sense of urgency created by the policy context that also ultimately softened member states' positions (European Commission 2010):

> I don't believe these differences are irreconcilable. If member states will not find a consensus on these issues now, they never will. The truth is that before the financial crisis conditions were not in place for presenting proposals in many of these areas [i.e financial market]. I can tell you that I carried out informal consultations in January 2008 with heads of states and governments to propose a code of conduct for rating agencies and the answer was "no" [...] Not anymore. Now, there is, I believe, an emerging consensus to act on these issues. Certainly, with some differences, some nuances, but in fact even at the G20 level - and it was Europe who started this process at the G20 summits - we already have some general agreements [...] Now, it is about taking concrete measures. We don't expect immediate agreement. [...] There are also diverging ideological positions. [...] The Commission is fulfilling its role to initiate legislation.

At the political level, the general position of the European Commission in 2010 regarding CRAs was clearly expressed by President Barroso. In a series of rhetorical questions asked during the June 2nd, 2010- press conference he pointed out a number of problems with CRAs that prompted the Commission to propose strong measures on rating agencies, but argued that the new regulations were not related to the sovereign downgrading of Greece that year:

> most commentators agreed that we need to look at the role performed by the credit rating agencies, especially the fact that they have underestimated the risk. The risk of Lehman Brothers, for instance. That has nothing to do with debt crisis. And in fact this raises an important point: is it normal to have only three relevant actors in such a sensitive issue where there is great probability of conflict of interest? Is it normal that all of them come from the same country? Is it normal that such important entities are in fact escaping fundamental regulation or supervision when they act in such important fields as they have been doing? I think that matter deserves

> at least some analysis [...] some quarters in the European Parliament and some member states have raised the issue of a European rating agency. We are considering that possibility [...] I personally believe that in the European Union member states we have a lot of competence in those areas [...] in terms of the so-called country risk. And so, if some of those entities want to explore that avenue, it's certainly an avenue that deserves to be considered. That was my position.

The policy positions of the key stakeholders presented above reveal two important sides in the CRA regulation debate. On the one hand, were those who supported the regulation: the Commission, public interest groups, trade unions and some member states - mainly those affected by the threat of sovereign rating downgrades. On the other hand, business opponents of CRA regulation included interest groups such as rating agencies, corporate bond issuers and banks, as well as member states that were less threatened by sovereign rating downgrades. The next section discusses the way in which the Commission's policy proposals reflected these preferences and offers an explanation for the lobbying success of interest groups with regard to the Commission proposal level.

Results and discussion

The Commission's proposal to introduce a CRA regulatory system in 2008, was already an important defeat for business groups, who wanted to avoid regulation and argued that the IOSCO Code was sufficient. Furthermore, the proposal was introduced as a regulation and not as a directive, which most business groups would have preferred. The proposal introduced a rules-based system instead of a principles-based system. In other words, it contained specific guidelines on what rating agencies needed to do to obtain authorization in the EU, to ensure oversight, to avoid conflicts of interest, to verify the quality of rating methodologies and to increase rating transparency.

Without authorization, the ratings of a CRA would not be recognized in EU member states. The authorization request had to contain a physical address for the rating agency in an EU member state –a measure business groups had opposed in the consultation. The request had to be sent to the CESR, which would then forward it to the relevant national authority. Registration and supervision would the responsibility of national regulatory agencies. These agencies were also given the right to withdraw the registration of a CRA the event of non-compliance with the regulation. The most intrusive provisions of the proposal on the activity of the CRAs concerned conflicts of interest. CRAs were required to make substantive changes to their corporate structure to separate the analytical and business sides of the rating company. Other measures prevented, for instance, analysts who had a financial interest in a rated entity from rating any financial instrument issued by that entity. On rating quality, the regulation contained a provision strongly opposed by business groups (European Commission 2008, Annex I, Section D):

> "A credit rating agency shall ensure that any credit rating states clearly and prominently any attributes and limitations of the credit rating. In particular, a credit rating agency shall prominently state in any credit rating whether it considers satisfactory the quality of information available on the rated entity and to what extent it has verified information provided to it by the rated entity or its related third part"

Finally, on the transparency issue, every CRA was required to "publicly disclose the names of the rated entities or related third parties from which it receives more than 5% of its annual revenue" (European Commission 2008, Annex I, Section B) and a list of its 20 largest clients by revenue. CRAs were also required to release an annual transparency report in which, among other things, they had to provide "detailed information on legal structure and ownership of the credit rating agency".

All of these provisions were, unlike the IOSCO Code, legally binding, and subject to penalties and fees applied by national regulators. During the press conference on the proposal's launch, Commissioner McCreevy noted that the "proposal goes farther than the rules existing in any other jurisdiction in the world" (European Commission 2008).

The 2011 Commission proposal further strengthened the CRA regulatory regime in significant ways. This was, again, the opposite of what CRAs - and business groups, more generally - sought. On the issue of over-reliance on ratings, it obliged banks, insurance firms and investment firms to carry out their own risk assessment, which would be verified by EU financial regulators, to complement external ratings from CRAs. The proposal introduced a civil liability procedure against CRAs for infringements of the Regulation and negligence, placing the burden of proof on CRAs to show that such infringements or negligence were unfounded. As a measure to prevent conflicts of interest, services from any one CRA could only be contracted for a maximum of 3 years, after which another contract would have to be signed with a different CRA. Also to prevent the conflicts of interest, the proposal prohibited ratings of any entity with controlling stake in the rating agency of 10% or more. While the issuer-pays model was not banned, the contract rotation and the restriction of ratings in certain instances imposed costs on CRAs. To enhance competition, the proposal prohibited large CRAs like S&P, Moody's or Fitch from acquiring small CRAs for a period of ten years. The Commission did not propose to set up a public rating agency due to costs and possible conflicts of interest, especially in rating sovereign debt.

The fact that business groups were less successful than public interest groups or trade unions in having their preferences included in the Commission proposal - contrary to popular expectations and some studies of lobbying success - might seem surprising. Some studies on EU interest representation suggest that lobbying success is biased in favor of business groups (Dür and Bièvre 2007, Bunea 2013). However, there is also growing evidence that business interest groups' lobbying success is often uncertain (Dr and Mateo 2014, Dür, Bernhagen et al. 2015). Among the reasons why business groups are sometimes less successful are contextual variables that are likely to have as much impact as interest group resources.

Why were business groups unsuccessful in the case of CRA regulation, although these groups were better represented in the consultations, with more than two thirds of the number of submitted contributions? Most business groups were strongly opposed to regulation, perhaps more than CRAs, while the Commission appeared determined to take a clear step in the opposite direction. Commissioner McGreevy's press declarations regarding the initial regulation clearly indicated stronger measures on credit rating. His successor, Michel Barnier, seemed particularly displeased by the accidental credit rating downgrade of his home country, France, on November 10, 2011 (European Commission 2011). A Commission spokesperson issued this statement on Barnier's behalf one day later, regarding the consequences of the downgrade for the financial market:

> The actors of this market must show a particularly increased sense of responsibility and rigor. It is even more important, as we are not dealing with any actor on the market, but with one of the three most important credit rating agencies, which in this respect has a particular responsibility [...] All that strengthens my belief that Europe must adopt a strict and rigorous legislation - particularly, but not only - on credit rating agencies. This has been my task in the past two years.

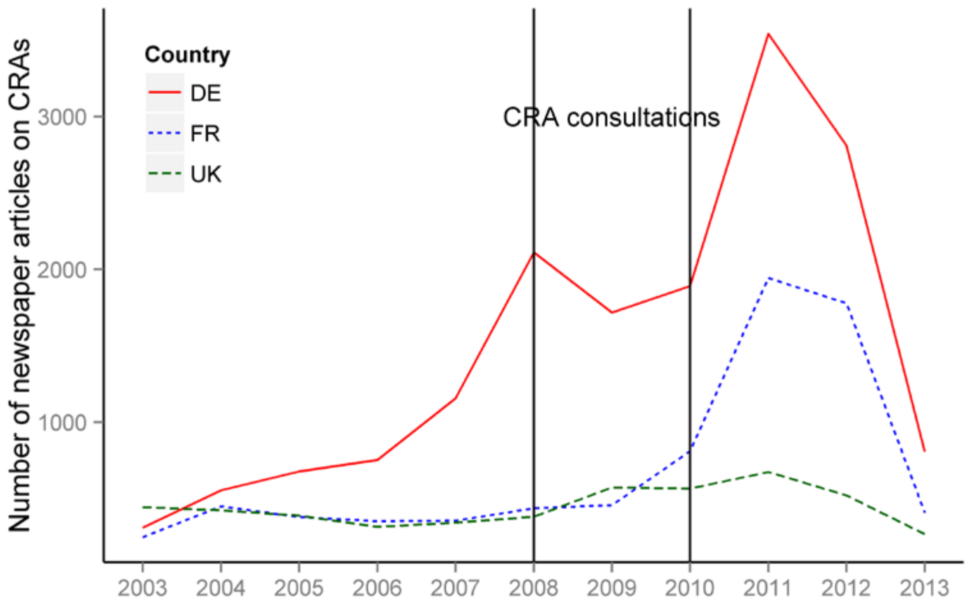
Four days later, Barnier made another press statement at the end of the Commissioners' College meeting in Strasbourg that illustrated his drive for stricter controls on financial markets. Referring to the influence of ratings on sovereign debt, his words were far from expressing an economically liberal point of view:

> The big debate going on today on the power of the markets relative to political power is a real debate. We must rebuild political sovereignty in order not to succumb to the power of the markets. This is how things work in modern democracies.

The fact that the Commissioner in charge of the regulation was French a time when rating agencies were threatening to damage the French economy with their downgrades arguably influenced the Commission's position. As recent findings indicate, "commissioners typically have strong ties to their home countries which influence the positions that they take with regard to legislative proposals [...]. Moreover, the appointment of the College of Commissioners is increasingly a political process in which party politics plays an important role [...]. It therefore might make a difference for lobbying which Commissioner is in charge of a legislative proposal" (Klüver et al. 2015).

At the same time, the high salience of the topic certainly played a role in determining the objectives of the Commission and of the French government, which carries an important weight in financial regulation among EU member state governments (Woll 2013). While the debate had previously revolved around whether regulation was needed at all, after the crisis the debate turned to *how much* regulation was needed to deal with such issues. Lobbying success on the rating industry side was about mitigating and managing the various issues that the regulation would address. Unlike therefore consisted of EU bureaucrats had considered proposing legislation on CRAs, during the financial crisis rating agencies and other business groups failed to stop a regulation proposal. Moreover, they did not manage to have their preferences included in the policy proposal, so as to diminish its effects. One of the main reasons for this outcome was the high public salience of rating agency regulation.

The salience of the credit rating issue, especially sovereign rating, increased significantly on the media agenda of the three largest EU economies. Media attention towards rating agencies increased exponentially in France after its sovereign downgrading, and French politicians across the spectrum to express their concern about the excessive power of CRAs. As shown in Figure 1, the number of articles concerning CRAs in French, German and British newspapers increased after the financial crisis, with more attention being given to the issue on the continent than in the UK. The data represent query results from the Factiva - Dow Jones database. The searches were made in Factiva's major news and business publications category in Germany, France and United Kingdom. For Germany, the search query was "Ratingagentur", for France it was "agence de notation", and for the UK the search was for "credit rating agency".



CRA regulation took place in the context of general discontent with the financial sector, as a result of numerous reports of fraud and mismanagement. The media was bent on identifying the culprits of the financial crisis and CRAs were quite high on the list. The economic and political circumstances in which the regulation was proposed were certainly crucial and unfavorable to business interests. Nevertheless, at the Commission level, the consultations around CRA regulation proposals were numerically dominated by business interests, who lobbied intensively through various channels in order to mitigate the effects of regulation.

It is reasonable to expect that rating agencies - who naturally opposed regulation - lost in this context, but why did other business groups follow suit? The explanation can be found in the dependence of other business groups on ratings. The status quo before the regulation of the credit rating market was preferred by most, so-called sectoral cohabitants. Sectoral cohabitants are companies that are part of the same business sector as the firms targeted by regulation (Pagliari and Young 2012). They enter into frequent contact with each other and their business success depends on the "symbiosis" between them. Thus, regulations targeting for the main group have a significant impact on the business of sectoral cohabitants. In addition to the fact that business groups are generally more likely to oppose regulation, the proposal on credit ratings was particularly important: ratings are an essential tool for the functioning of financial markets, not only because of the use of ratings in regulatory standards, but also because they provide an automatic justification for prices and investment decisions. If a bank (most often an investment bank) is unable to rely on credit ratings to increase its leverage, due to credit rating regulation, that bank is likely to strongly oppose such regulation. Moreover the issuer-pays model and the credit rating process were favored over any alternatives that could be introduced by regulation.

The perception in the Commission was that after banks, credit rating agencies played a central role in the development of the financial crisis. In particular, conflicts of interest - banks owned major shares in rating agencies that were evaluating their products - and the financial speculation over sovereign debt downgrades triggered a firm counter - reaction to such behavior in the Commission. It is not surprising in this context that other public authorities have also reacted firmly and lobbied for stricter regulation of the rating industry. Member states in which financial speculation based on sovereign downgrades was more severe, such as Portugal, Greece or France, were particularly concerned and requested more regulation.

Overall, the case of credit rating agency regulation illustrates the importance of contextual factors for lobbying success. In this case, although interest group mobilization was highly biased towards business interests, lobbying success was not biased in their favor. The findings also suggest that large-N studies can improve their design by paying more attention to the measurement of contextual variables such as the perception and preference of decision-makers regarding each policy issue.

Conclusion

This study aimed to explain the variation in lobbying success among the participants in the consultation on credit rating agencies' regulation in the EU Commission. The independence and quality of credit ratings has long been questioned, not only because of the possible conflicts of interest inanticipate is largely a "private business", but also because of the failure of the rating industry to signal the default of important financial enterprises. Prompted by the economic crisis that started in 2008, the regulatory framework on credit ratings was a new initiative in the financial sector. The main question was how successful were interest groups in obtaining a regulation proposal that aligned as closely as possible with their policy preference? The results show that public interest groups were the winners of this process. Factors related to the policy context, which are held constant in the design of this analysis, appeared to have an important effect on determining the winners and the losers in this case. Nonetheless, these results should be further investigated by research designs that combine the study of exceptional cases and large-N observation.

Lobbying success in the EU regulation on CRAs can be better understood in the context of the broader measures taken by European authorities in an attempt to change market behavior in the aftermath of a severe economic crisis. The financial crisis triggered a wave of regulatory measures that significantly altered the common perception that the EU is a "soft governance" system (Dehousse 2015). Indeed, the financial crisis has shown that unless extensive financial reforms are adopted, the stability and function of the European financial system itself might be irreversibly compromised. While there is no doubt that the Commission took important steps to implement such reforms - most of which were opposed by business groups - old habits persist in the financial sector. Further research could focus on other topics, such as the (lack of) measures against capital flight to tax havens, in order to examine the influence of business actors on financial regulation.

References

ALCUBILLA, Raquel Garca and Javier Ruiz DEL POZO, *Credit rating agencies on the watch list: Analysis of European regulation,* Oxford University Press, 2012.

B. B. C. NEWS. ITALIAN DAIRY BOSS GETS 10 YEARS. 2008 (http://news.bbc.co.uk/2/hi/business/7790803.stm, last accessed on August 18, 2015).

B. B. C. NEWS. Europe's PIGS: Country by country. 2010 (http://news.bbc.co.uk/2/hi/8510603.stm, last accessed on August 18, 2015).

BAUMGARTNER, Frank R., Jeffrey M. BERRY, Marie HOJNACKI, David C. KIMBALL and Beth L. LEECH, *Lobbying and Policy Change. Who Wins, Who Loses, and Why,* University of Chicago Press, 2009.

BUNEA, Adriana. Issues, preferences and ties: determinants of interest groups' preference attainment in the EU environmental policy. *Journal of European Public Policy* 2013 20(4): 552-570.

BUNEA, Adriana and Frank R. BAUMGARTNER. The state of the discipline: authorship, research designs, and citation patterns in studies of EU interest groups and lobbying. *Journal of European Public Policy* 2014 21(10): 1412-1434.

CANTOR, Richard and Frank PACKER. The Credit Rating Industry. *Federal Reserve Bank of New York Quarterly Review* 1994 19(2): 1-26.

CESR, *CESR's technical advice to the European Commission on possible measures concerning credit rating agencies,* 2005.

CESR, *CESR's report to the European Commission on the compliance of Credit Rating Agencies with the IOSCO Code.,* 2006.

CESR, *CESR's second report to the European Commission on the compliance of Credit Rating Agencies with the IOSCO Code. The role of credit rating agencies in structured finance.,* 2008.

CESR, *Report by CESR on compliance of EU based Credit Rating Agencies with the 2008 IOSCO Code of Conduct,* 2009.

COLLIER, David. Understanding Process Tracing. *Political Science and Politics* 2011 44: 823-830.

COSKUN, Deniz. Credit rating agencies in a post-Enron world: Congress revisits the NRSRO concept. *Journal of Banking Regulation* 2008 9(4): 264-283.

DEHOUSSE, Renaud. Has the European Union moved towards soft governance? *Comparative European Politics* 2015 (forthcoming).

DUCOURTIEUX, Cecile and Anne MICHEL. Nous ne sommes pas des "supermen" mais des analystes independants. *Le Monde* 2004 (18354): 21.

DÜR, Andreas, Patrick BERNHAGEN and David MARSHALL. Interest group success in the European Union: when (and why) does business lose? *Comparative Political Studies* 2015 48(8): 951-983.

DÜR, Andreas and Dirk de BIÈVRE. Inclusion without influence? NGOs in European trade policy. *Journal of Public Policy* 2007 27(1): 79-101.

DÜR, Andreas and Gemma MATEO. Public opinion and interest group influence: how citizen groups derailed the Anti-Counterfeiting Trade Agreement. *Journal of European Public Policy* 2014 21(8): 1199-1217.

EGDELL, Janet M. and Kenneth J. THOMSON. The influence of UK NGOs on the common agricultural policy. *Journal of Common Market Studies* 1999 37(1).

EUROPEAN COMMISSION. Call to CESR for technical advice on possible measures concerning credit rating agencies. 2004.

EUROPEAN COMMISSION. Communication from the Commission on Credit Rating Agencies. *Official Journal of the European Union* 2006 49 (C 059).

EUROPEAN COMMISSION. Press Conference on Credit Rating Agencies. 2008 (SPEECH/08/605).

EUROPEAN COMMISSION. Press Release: Consultation by the Commission services on Credit Rating Agencies (CRAs). 2008 (IP/08/1224).

EUROPEAN COMMISSION. Proposal for a Regulation of the European Parliament and of the Council on Credit Rating Agencies. 2008 (2008/0217 (COD)).

EUROPEAN COMMISSION. Public consultation on credit rating agencies. 2010 (http://ec.europa.eu/internal_market/consultations/docs/2010/cra/cpaper_en.pdf, last accessed on August 18, 2015).

EUROPEAN COMMISSION. Recorded EC Press Event, Reference:I-066189. 2010 (http://ec.europa.eu/avservices/video/player.cfm?sitelang=en&ref=I066189, last accessed on August 18, 2015).

EUROPEAN COMMISSION. Statement by Commissioner Michel Barnier following the incorrect rating of France by Standard & Poor's. 2011 (MEMO/11/777).

EUROPEAN PARLIAMENT. European Parliament resolution on corporate governance and supervision of financial services - the Parmalat case. 2004 (PE 341.223).

EUROPEAN PARLIAMENT. European Parliament resolution on Role and methods of rating agencies. 2004 (PE 341.221).

FAIOLA, Anthony. Debt crisis unsettles European economy. *Washington Post* 2010 (http://www.washingtonpost.com/wp-dyn/content/article/2010/02/05/AR2010020504411.html, last accessed on August 18, 2015).

FLANDREAU, Marc, Norbert GAILLARD and Frank PACKER. To err is human: US rating agencies and the interwar foreign government debt crisis. *European Review of Economic History* 2011 15(3): 43.

FRANTZ, Pascal and Norvald INSTEFJORD. Rules vs Principles Based Financial Regulation. *Available at SSRN 2561370* 2014.

GREEN-COWLES, Maria. Setting the agenda for a new Europe: The ERT and EC 1992. *Journal of Common Market Studies* 1995 33(4): 501-526.

HOOPER, John and Mark MILNER. Parmalat 'is Europe's Enron'. *The Guardian* 2003(http://www.theguardian.com/business/2003/dec/20/corporatefraud.parmalat).

KINGDON, John W., *Agendas, Alternatives, and Public Policies,* HarperCollins, 1995.

KLÜVER, Heike. The Contextual Nature of Lobbying: Explaining Lobbying Success in the European Union. *European Union Politics* 2011 12(4): 483--506.

KLÜVER, Heike. Biasing Politics? Interest Group Participation in EU Policy-Making. *West European Politics* 2012 35(5): 1114-1133.

KLÜVER, Heike, *Lobbying in the European Union. Interest Groups, Lobbying Coalitions and Policy Change,* Oxford University Press, 2013.

KLÜVER, Heike, Caelesta BRAUN and Jan BEYERS. Legislative lobbying in context: towards a conceptual framework of interest group lobbying in the European Union. *Journal of European Public Policy* 2015 22(4): 447-461.

LANGOHR, Herwig and Patricia LANGOHR, *The rating agencies and their credit ratings: what they are, how they work, and why they are relevant,* John Wiley & Sons, 2008.

LOWERY, David, Caelesta POPPELAARS and Joost BERKHOUT. The European Union Interest System in Comparative Perspective: A Bridge Too Far? *West European Politics* 2008 31(6): 22.

MAHONEY, Christine. The Power of Institutions. State and Interest Group Activity in the European Union. *European Union Politics* 2004 5(4).

MAHONEY, Christine, *Brussels versus the Beltway: Advocacy in the United States and the European Union,* Georgetown University Press, 2008.

MICHALOWITZ, Irina. What Determines Influence? Assessing Conditions for Decision-Making Influence of Interest Groups in the EU. *Journal of European Public Policy* 2007 14(1).

OAKLEY, David. Sovereigns: Debt levels raise fears of further downgrades. *Financial Times* 2010 (http://www.ft.com/intl/cms/s/0/599d9f3c-2009-11df-81a2-00144feab49a.html#axzz3jRaxQzZJ, last accessed on August 18, 2015).

PAGLIARI, Stefano and Kevin YOUNG. Who Mobilizes? An Analysis of Stakeholder Response to Financial Regulatory Consultations. 2012.

PARTNOY, Frank. How and Why Credit Rating Agencies Are Not Like Other Gatekeepers. 2006.

PORTES, Richard. Rating agency reform. *Vox Eu* 2008 (http://www.voxeu.org/article/ratings-agency-reform).

SCALET, Steven and Thomas F. KELLY. The ethics of credit rating agencies: What happened and the way forward. *Journal of Business Ethics* 2012 111(4): 477--490.

SCHARPF, Fritz W., *Governing in Europe: Effective and Democratic?,* Oxford University Press, 1999.

SINCLAIR, Timothy J., *The New Masters of Capital: American Bond Rating Agencies and the Politics of Creditworthyness,* Cornell University Press, 2005.

SY, Amadou N. R. The Systemic Regulation of Credit Rating Agencies and Rated Markets. *International Monetary Fund Working Paper* 2009 (WP/09/129).

SYLLA, Richard. An historical primer on the business of credit rating. 2002: 19--40.

TAYLOR, Simon. Credit Rating Agencies Blamed for Market Losses. *European Voice* 20 September.

THOMSON, Robert, Frans N. STOKMAN, Christopher H. ACHEN and Thomas KONIG, *The European Union Decides,* Cambridge University Press, 2006.

UNITED STATES SENATE, Committee on Governmental Affairs. Financial Oversight of Enron: The SEC and Private-Sector Watchdogs. 2002 (S. Prt. 107-75).

WAKEMAN, L. Macdonald. The real function of bond rating agencies. *Chase Financial Quarterly* 1981 1(1): 18-26.

WOLL, Cornelia. Lobbying under Pressure: The Effect of Salience on European Union Hedge Fund Regulation. *Journal of Common Market Studies* 2013 51(3): 552-572.

ZÜRN, Michael. Democratic governance beyond the nation-state: The EU and other international institutions. *European Journal of International Relations* 2000 6(2): 183-221.