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An analysis of the competitive situation on the EU rating market in context of regulatory requirements

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Content

1. Introduction

- The market for external ratings is mainly dominated worldwide by the three major rating agencies („Big Three“):

Standard & Poor’s (S&P)

Moody’s

Fitch Ratings

- Ratings provide information about default risk of issuers and financial instruments in the area of debt capital.

1. Introduction

- Ratings facilitate placements in debt capital markets.

- The importance of ratings has already increased in the 1970s. In capital market regulation, they had become increasingly part of regulatory rules.

1. Introduction

- In connection with the 2008 starting financial crisis, the rating agencies and their ex post incorrect assessments within an oligopolistic market structure had come under increasing criticism.

- EU legislator reacted with the **EU-Rating-Regulation** that came into force in 2009.

2. <u>The oligopolistic market structure</u>

- An important aspect for the is the regulatory institutionalization of ratings.

- The recognition as U.S. **Nationally Recognized Statistical Rating Organization (NRSRO)** was awarded for the first time by the U.S. supervisory authority Securities and Exchange Commission (SEC) in **1975**.
  - ➢ Consequently, only ratings of companies with NRSRO status could be used to determine banks' capital requirements.
  - ➢ In this context, the SEC directly determined the rating agencies **S&P**, **Moody's** and **Fitch Ratings**.

2. The oligopolistic market structure

- The **EU-Rating-Regulation** (Regulation (EC) No 1060/2009) entered into force at European Union (EU) level in **2009**.

- The **aim** of the regulation is to ensure a **high level of consumer and investor protection** by applying **common quality requirements** for ratings given within the EU.

- The regulation also stipulates that a rating agency has to apply for registration in order to be recognized as an external rating agency (External Credit Assessment Institution (ECAI)).

2. The oligopolistic market structure

esma European Securities and Markets Authority

- The admission and registration requirements can be seen as an **obstacle to entering the rating market**.

- **Effectiveness of ratings** can only be observed ex post.
  - requires trust in the analysis
  - many years of experience
  - reputation for the quality of the rating

3. Empirical analysis

- The regulatory measures at EU level clarify, among other things:
  - efforts to increase competition on the rating market or
  - reduce the dominance of the three major rating agencies.

- The following **hypothesis** can be derived on the basis of the research question:

  Since the EU Rating Regulation came into force, the market shares of the three major rating agencies and the oligopolistic market structure of the rating market in the EU have remained unchanged.

3. Empirical analysis

- To test the hypothesis, **key figures** from the overall rating market and the three major rating agencies are determined over a certain period of time.

    - **Revenues**
    - **Number of registered credit rating agencies**
    - **Market share**

3. Empirical analysis

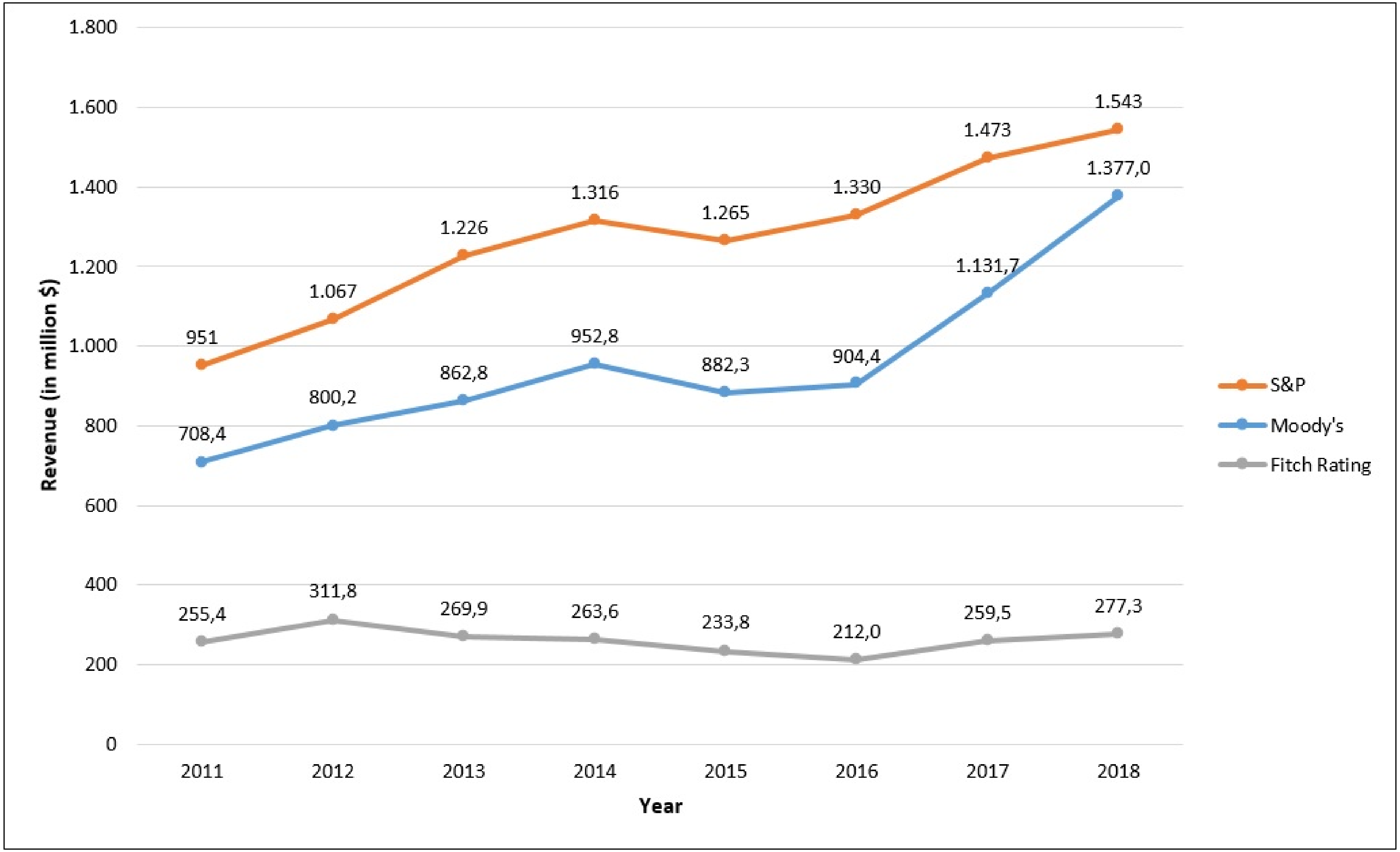

Figure 1: Revenues of the three major credit rating agencies in segments including the European Union 2011-2018

3. Empirical analysis

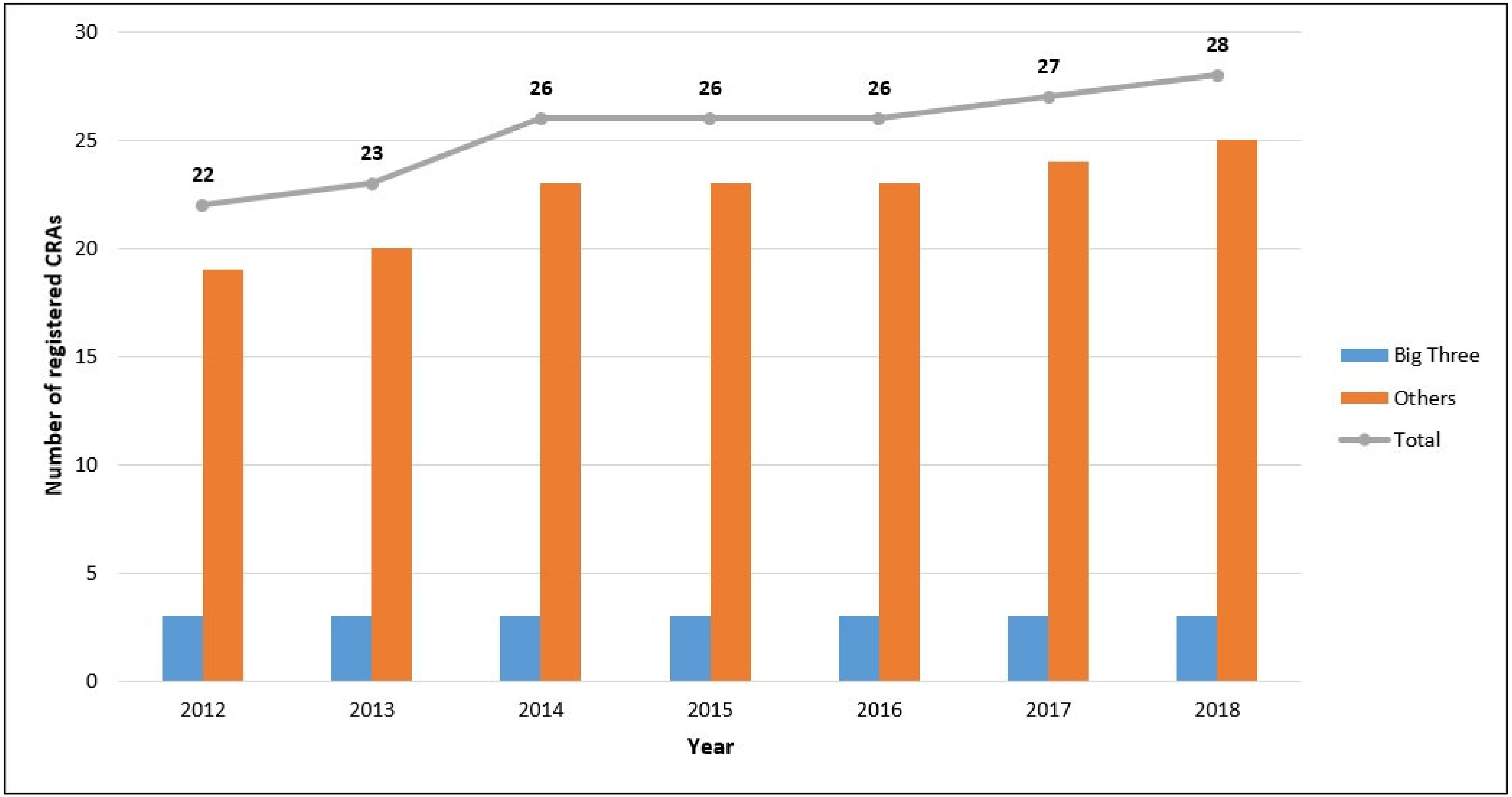

Figure 2: Number of registered CRAs in the EU 2012-2018

3. Empirical analysis

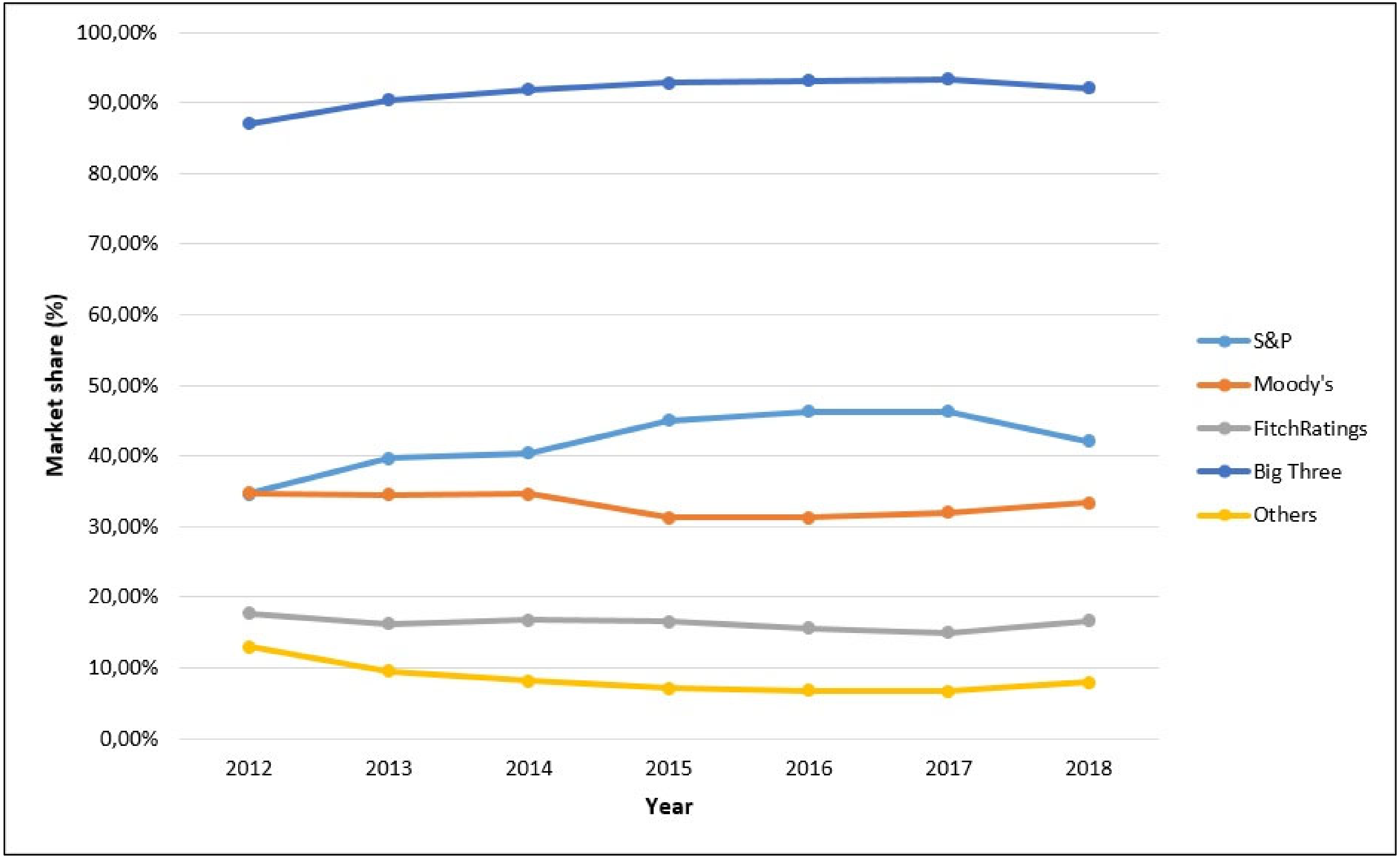

Figure 3: Market share of registered CRAs in the EU 2012-2018

4. Interpretation of the results

- The revenues of the Big Three in the EU (in conjunction with the analysis of market shares) have remained constant.
- A stagnation or general decline in revenues of the Big Three in the period under review, which could indicate lower market power or increased competition, cannot be identified with this key figure.

4. Interpretation of the results

- In 2018 the number of ESMA registered agencies in addition to the Big Three is 25.

- The number has increased since 2012 from 22 registered agencies to a total of 28 in 2018.
  - Increase of approximately 27 percent over the entire period.

- It shows that there is potential to use other rating agencies and their services.
  - Considering the market shares, this has apparently not yet been exploited.

4. Interpretation of the results

- The results over the observation period from 2012 to 2018 show the expected clear dominance of the **Big Three** with **over 90 percent market share**.
- The slight increase in the number of rating agencies does not have the effect that they lose market share on a larger scale.
- Since the entry of the European Union Rating Regulation came into force, the **dominant market shares** of the Big Three have remained largely **unchanged.**
- The associated oligopolistic market structure has pursued to exist in the EU.

4. Interpretation of the results

- To date, efforts to strengthen competition and reduce the dominance of the Big Three associated with the EU regulation have not been achieved.

- Consequently, the hypothesis formulated at the beginning can be validated.

- It can be said that the oligopolistic market structure and the associated market power of the Big Three continue.

4. Interpretation of the results

- However, efforts with a chance to be operational should continue to be promoted on the basis of regulation.

- Alternative endeavors always have to assert themselves on the market and will find it difficult to form a competitive alternative.
  - This includes, for example, a **network of small rating agencies**

5. Conclusion

- The dominance of the major rating agencies S&P, Moody's and Fitch can be **historically** explained.

- On the other hand, the dominant position can be explained by the **reputation** of the agencies, which results from their many years of experience.

- In summary, it can be stated that bare regulatory requirements do not automatically change the competitive situation or that the oligopolistic market structure is necessarily changed as a result.

Contact

Thank you
for your attention

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