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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on the appropriateness of the development of a European creditworthiness assessment for sovereign debt

I. Introduction

The recent EU sovereign debt crisis revealed macro-economic imbalances and highlighted the risks associated with over-reliance on external credit ratings of sovereign debt. Credit ratings of sovereign debt play a role in determining the borrowing costs of governments. During the crisis, over-reliance on credit ratings created market disruption which could, under certain circumstances, undermine financial stability in the EU.

The negative impact of over-reliance on sovereign credit ratings can be mitigated if investors in the European sovereign bonds market assess the creditworthiness of European sovereigns themselves, instead of relying solely and mechanistically on external credit ratings. To do so, they should be equipped with accurate and relevant information to carry out their own credit risk assessment of sovereigns.

A good appreciation of the creditworthiness of European sovereigns facilitates investment in EU Member States' sovereign bonds. This contributes to investors' overall market confidence in individual Member States, which influences their investment decisions towards other asset classes in those Member States, for example investments in corporates and financial institutions incorporated there. The availability of appropriate and accurate information on the creditworthiness of European sovereigns could contribute to President Juncker's Political Guidelines as an underlying element for stimulating investment.

This report describes the risks observed due to over-reliance on ratings of sovereign bonds (section II) and the policy response to date (section III). The report subsequently analyses if the existing sources of information are sufficient and adequate for investors to allow them to carry out their own credit risk assessment of sovereigns (section IV) or whether, an additional tool - possibly in the form of a European creditworthiness assessment for sovereign debt[1] – is appropriate and could complement the existing information (sections V and VI).

II. Over-reliance on external ratings in sovereign bonds markets

1. Risks of over-reliance on sovereign bond ratings

The recent sovereign debt crisis highlighted the risks of over-reliance on sovereign credit ratings. The crisis showed that under certain economic conditions, this over-reliance could create "cliff effects" whereby investors reduce their exposures to certain sovereign bonds and other debt instruments with the potential to undermine financial stability. Such "cliff effects" can occur following a credit rating downgrade, in particular below a certain threshold. This can have an additional liquidity effect due to the need to meet regulatory capital requirements. This became evident during the most recent financial crisis when worsening economic forecasts put pressure on public finances. This led to downgrades of sovereign bonds causing a simultaneous selling off of debt instruments by financial institutions and investors. These market reactions were re-enforced by references to

[1] Article 39b(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, OJ L 302, 17.11.2009, p.1 ("CRA Regulation").

ratings in some financial legislation[2] as well as contractual over-reliance on ratings by financial institutions.

The potential impact of sovereign ratings goes far beyond the immediate effects on the sovereign bonds of the rated countries and can result in negative spill overs across markets and even across countries which have significant economic links ("contagion effect"). These effects are strengthened by the inter-linkages between sovereign credit ratings and ratings of entities within those sovereigns. These links result from the methodologies used by credit rating agencies which often limit the most favourable credit rating of any financial instrument within a given jurisdiction to the rating of the sovereign (often referred to as a "sovereign ceiling"). As a consequence, the downgrade of a sovereign often triggers downgrades of other financial instruments located in the sovereign, including corporate bonds and financial institution ratings.

2. Observations on sovereign debt ratings and EU bonds markets

Empirical evidence from the EU sovereign debt crisis has shown "*[...] a significant response of government bond yield spreads to changes in both the rating notations and the rating outlook, particularly important for the case of negative announcements*"[3]. Furthermore, it has been demonstrated that "[…] *sovereign rating downgrades have statistically and economically significant spillover effects both across countries and financial markets implying that rating agencies announcements could spur financial instability*"[4].

Chart 1 shows that up to 2008, credit ratings of euro area Member States were on average higher than those of non-euro area Member States. While the average credit rating of

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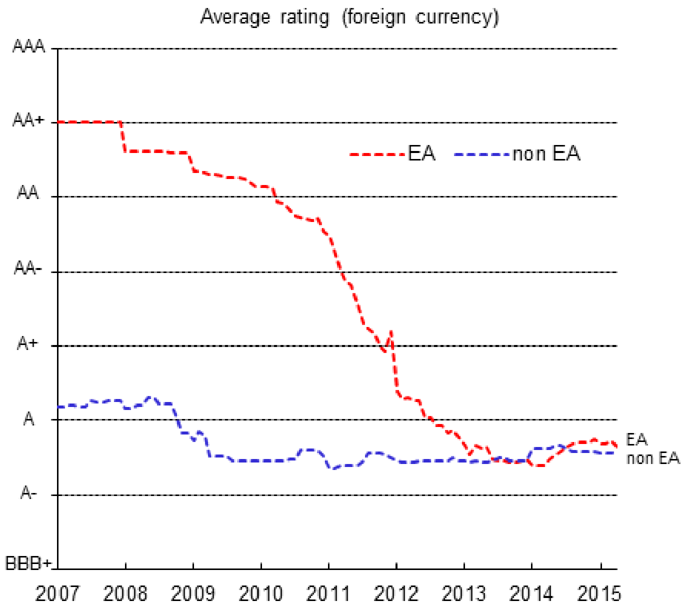
[2] For example, references to external credit ratings can be found in the standardized approach for calculating capital requirements for banks (Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, p. 338 (CRD IV) and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013, p. 1 (CRR)) and in capital requirements for insurance undertakings (Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance, OJ L 12, 17.1.2015, p. 1 (Solvency II)) and in margin requirements for non-centrally cleared counter parties.

[3] António Afonso, Davide Furceri, Pedro Gomes, Sovereign Credit Ratings and Financial Market Linkages, Application to European Data, ECB working paper series, number 1347, October 2011, available at: https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1347.pdf

[4] Rabah Arezki, Bertrand Candelon and Amadou N. R. Sy, Sovereign Rating News and Financial Markets Spillovers: Evidence from the European Debt Crisis, March 2011,IMF working paper series, nr WP/11/68, available at: http://www.imf.org/external/pubs/ft/wp/2011/wp1168.pdf; António Afonso, Pedro Gomes and Abderrahim Taamouti, Sovereign Credit Ratings, Market Volatility and Financial Gains, ECB working paper series, nr 1654, March 2014, available at: https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1654.pdf

euro area Member States was "AA+"[5], non-euro area Member States were rated on average "A". Only after the financial crisis, in the period 2009-2010, Member States within and outside the euro area observed a limited and similar deterioration of credit ratings of, on average, two notches. Furthermore, from the beginning of 2011, euro area Member States observed steep downgrades, from an average of "AA" in 2011 down to "A-" in 2013. The average credit rating of euro area Member States is now stronger than non-euro area Member States after converging in 2013 to the level of "A-".

Chart 1: Sovereign rating trends in the EU[6]



Source: own calculations by the European Commission

Chart 2 and 3 demonstrate the evolution of credit ratings of a selected number of both euro area and non-euro area Member States, which supports the above analysis. Before 2009, the sample of euro area countries were rated "A" or higher as shown in chart 2. During the sovereign debt crisis, a number of Member States'[7] credit ratings dropped sharply in the period 2010-2012 and improved moderately since end 2013.

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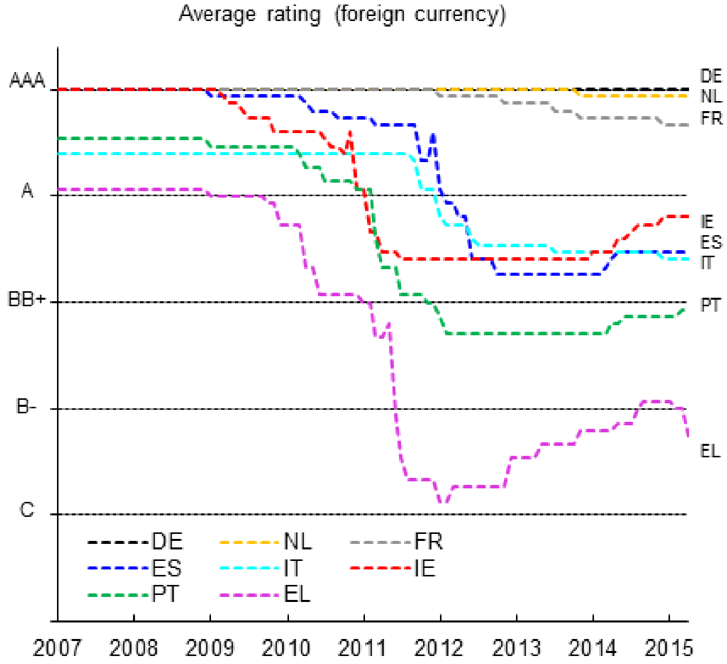
5 To facilitate the presentation in chart 1, credit ratings issued by three different agencies (Standard & Poor's, Moody's and Fitch) were mapped towards a single rating scale ranging from AAA (lowest credit risk) to D (highest credit risk). The full scale employed for the mapping is following: AAA AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB-, BB+, BB, BB-, B+, B, B-, CCC+, CCC, CCC-, CC+,CC, CC-, C+, C, C- and D. It should be taken into account while interpreting chart 1 that the underlying rating methodologies differ among the rating agencies employed in the sample.

6 The chart displays a simple unweighted average of long-term foreign currency sovereign ratings for euro area and non-euro-area Member States issued by Standard & Poor's, Moody's and Fitch. The average synthetic rating was obtained based on the distance (number of notches) from the triple-A rating and comprises the average rating of those credit rating agencies with sufficient cross-country coverage. Foreign currency ratings are favoured over local currency ratings for international comparisons because the latter includes the exchange rate risk international investors are exposed to.

7 IE, EL, ES, IT, PT

Chart 2: Sovereign rating trends in the euro area



Source: own calculations European Commission

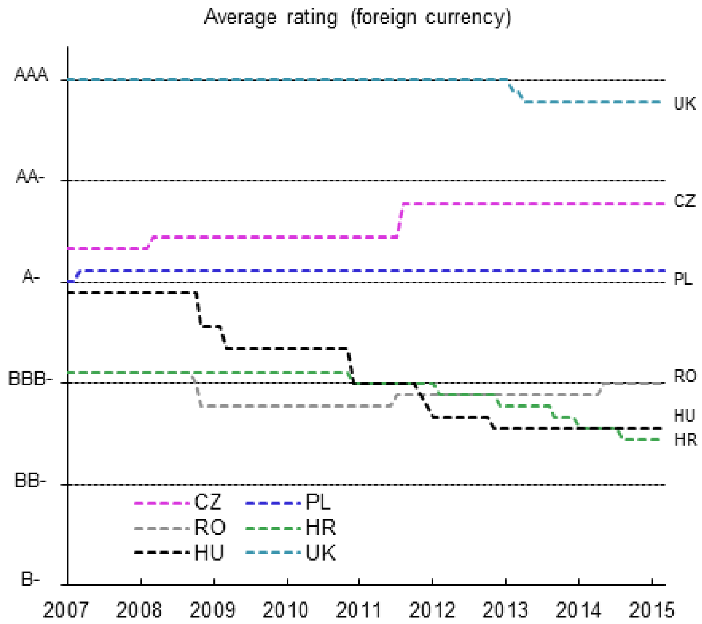
For non-euro area Member States a much more diverse spectrum of credit ratings was observed before, during and after the sovereign crisis (Chart 3). While some non-euro area Member States had a relative stable credit rating[8], some others had a downward[9] or upward[10] evolution.

[8] PL, RO

[9] HR, HU, UK

[10] CZ

Chart 3: Sovereign rating trends in non-euro area Member States



Source: own calculations European Commission

3. Yields of sovereign bonds

The yields of sovereign bonds are an important indicator of investors' perception of the credit risk profile of a sovereign. Prior to the sovereign debt crisis, yields of euro area bonds were broadly converging[11], suggesting that investors had the same stance toward the creditworthiness of euro area Member States as demonstrated in Chart 4. During the crisis this changed considerably. Since 2008 investors decreased their demand for specific sovereign bonds[12] or required higher returns as reflected in the evolution of yields[13]. For some other euro area Member States a downward trend in sovereign bond yields was observed. Since 2013, euro area sovereign bond yields have been gradually

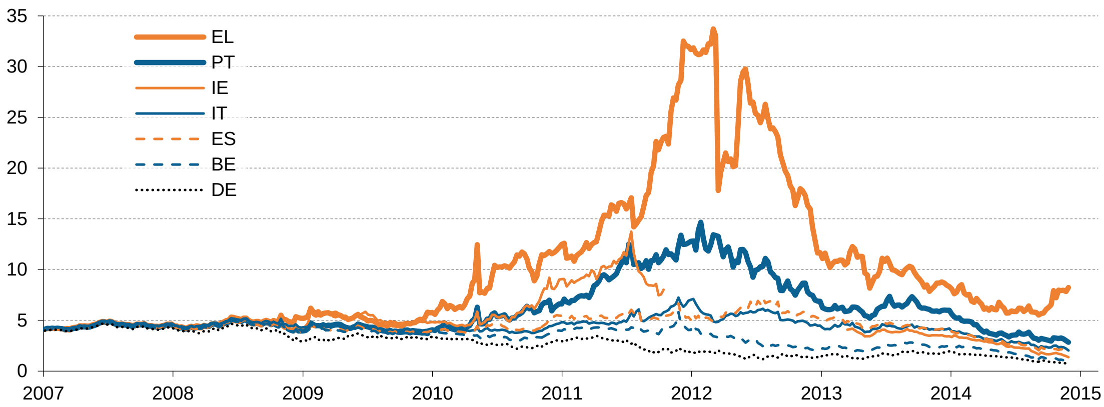
[11] See Chart 4.

[12] ES, PT, IT, IE, EL and CY

[13] See Chart 4.

evolving towards pre-crisis levels. However, important divergences remain across individual euro area Members States (Chart 4).

Chart 4: Yields, 10-year government bonds, percentage



Source: Bloomberg

III. Policy response to mitigate risks of over-reliance on sovereign debt ratings

1. Enhanced regulatory scrutiny over credit rating agencies

Following the inadequacies in credit ratings observed during the financial crisis and subsequent sovereign debt crisis, new rules for credit rating agencies (CRAs) were put in place in 2009 which included registration and supervision requirements for CRAs at national level. In 2011, registration and supervision of CRAs in the EU was centralised within the European Securities and Markets Authority (ESMA).

2. Enhanced transparency on sovereign debt ratings

Following the sovereign debt crisis, additional measures were introduced in 2013 to enhance transparency and timeliness of sovereign debt ratings, thereby contributing to reducing risks of market disruption.

In particular, CRAs have to publish annually a calendar setting the dates for the publication of their sovereign credit ratings. Sovereign debt credit ratings shall also be published on Fridays, after close of business of regulated markets in the EU, to avoid market disruption during trading hours. CRAs shall complement the credit rating with a full research report which provides investors with more information on the underlying reasons for a sovereign rating change. In addition, CRAs shall inform the sovereign during working hours, and at a least a full working day before publication, of the credit rating and the rating outlook. This provides the sovereign, just as any other rated entity, the opportunity to highlight any factual errors to the CRA.

The combined effect of these rules has enhanced the transparency of sovereign debt ratings. Investors are now provided with more information on the underlying reasons and assumptions of sovereign credit ratings issued by CRAs as well as the data they relied upon. The additional information on sovereign ratings could facilitate and enhance the ability of investors to carry out more accurate creditworthiness assessments of sovereign debt.

Despite these regulatory efforts, a 2013 report from ESMA[14] revealed shortcomings in the sovereign ratings process which could pose risks to the quality, independence and integrity of the ratings and of the rating process. In this report, ESMA identified risks relating to conflicts of interests arising from the role of senior management and other non-rating functions in the rating process and from the involvement of sovereign analysts in research and publication activities. The report outlined the risks of breaching of confidentiality of sovereign rating information and the controls in place prior to the publication of ratings. The report also highlighted the risks related to the timing of publication of sovereign ratings, including timely disclosure of rating changes. As part of the supervisory process, ESMA requested CRAs to implement action plans to remedy this situation. Ultimately, ESMA is empowered to take supervisory action if appropriate.

3. Reducing over-reliance on external credit ratings

In response to risks and negative effects of solely and mechanistically relying on credit ratings (which includes sovereign credit ratings), action was taken at international level to reduce over-reliance on credit ratings, with the aim of restoring trust in the financial system. The Financial Stability Board (FSB) Principles[15] to reduce reliance on CRA ratings in standards, laws and regulations were endorsed by G20 Leaders in November 2010 (Seoul Summit)[16]. The Principles aim to end mechanistic reliance on credit ratings by banks, institutional investors and other market participants; introduce a significant change in existing practices; and to establish stronger internal credit risk assessment practices as an alternative.

Effective reduction of over-reliance on external credit ratings, including on sovereign credit ratings, could reduce risks of cliff effects in case of sovereign downgrades. In its

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[14] Credit Rating Agencies: Sovereign ratings investigation, ESMA's assessment of governance, conflicts of interest, resourcing adequacy and confidentiality controls, Published 02 December 2013, reference ESMA/2013/1775

[15] Principles for Reducing Reliance on CRA Ratings, Financial Stability Board, 27 October 2010.

[16] G20, Seoul Summit Document, p. 8, available at: https://g20.org/wp-content/uploads/2014/12/Seoul_Summit_Document.pdf

response to the FSB[17], the European Commission outlined its actions to mitigate risks of reliance of ratings. As a follow up, the European Commission will report on alternative measures to assess credit risk and identify if there are viable alternatives available and determine if it is feasible for market participants to implement them. Based on the outcome of this report, the Commission could consider removing remaining references to credit ratings in EU legislation by 2020.

In addition, the Commission supports the G20 Data Gaps initiative[18], which aims to improve the availability and comparability of economics and financial data at international level. One of the recommendations (R17) is to promote timely, cross-country standardised government financial statistics based on common international accepted standards.

4. Assessing a European creditworthiness assessment for sovereign debt

As part of the policy response to reducing the over-reliance on sovereign credit ratings, it is necessary for investors to have appropriate information to assess the creditworthiness of Member States. Such information should enable investors to make their own credit risk assessment of sovereigns and not rely solely and mechanistically on external credit ratings issued by credit rating agencies.

The Commission already collects, processes and publishes data on the economic, financial and fiscal situation and performance of Member States, in the context of the surveillance of economic and fiscal policies. The Commission has been invited to explore whether this reporting should be complemented by additional elements or indicators and to examine the possibility of developing a European creditworthiness assessment. This could allow investors to make an impartial and objective assessment of Member States' creditworthiness.

The Commission will therefore, "taking into consideration the situation of the market, *[…] submit a report to the European Parliament and to the Council on the appropriateness of the development of a European creditworthiness assessment for sovereign debt."*[19] This report will feed into the upcoming Report of the Commission on the appropriateness and feasibility of supporting a European CRA which is due by the end of 2016.[20]

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17 Commission Staff working paper: EU action plan to reduce reliance on external credit ratings, available at : http://ec.europa.eu/finance/rating-agencies/docs/140512-fsb-eu-response_en.pdf

18 •IMF-FSB, The Financial Crisis and Information Gaps. Report to the G-20 Finance Ministers and Central Bank Governors, October 29, 2009, available at: http://www.imf.org/external/np/g20/pdf/102909.pdf

19 Article 39b (2), first subparagraph, of the CRA Regulation

20 Article 39b(2), second subparagraph, of the CRA Regulation

IV. Gap analysis between investors' needs and information supply

As previously highlighted, access to sufficient and adequate information facilitates investors to make their own creditworthiness assessment and reduce reliance on sovereign ratings. This section outlines the type of information used by investors and compares it with the information available to determine whether there are any material information gaps.

1. Investors' information needs

A) Types of investors and information needs

A distinction can be made between large, mainly institutional, investors and smaller investors. Where these investors seek to access sovereign bond markets, they have similar information needs regarding those sovereigns but different capabilities to assess sovereign credit risk.

For the purpose of developing this report, the Commission conducted interviews with a limited number of large institutional investors such as banks, pension funds and asset managers, and some smaller asset managers. Based on this feedback the most relevant information employed to assess creditworthiness of sovereigns is the data on the macro-economic, fiscal strength and performance of sovereigns. This includes quantitative data such as the change of gross domestic product (GDP), government debt levels and maturity structure, government deficit, unemployment rate and competitiveness. Furthermore, qualitative information on the rule of law and good governance and the political situation is considered of relevance.

The large institutional[21] investors interviewed reported, that they assessed the creditworthiness of sovereign debt for investment decisions and for prudential purposes and that there is a requirement for comparable data on sovereign debt globally, not only the EU, due to the global reach of their businesses and the needs of their clients.

To obtain data that is comparable to conduct their own credit risk assessment, the investors interviewed often employ the services of private data providers who consolidate information on sovereigns from multiple public and private sources and provide an automatised data-stream. They often employ their own analysts and some assign their own internal ratings to sovereigns. Furthermore, some institutional investors indicated interacting directly with national authorities, such as National Debt Agencies and Treasuries.

On the other hand, the smaller investors reported that they had more limited resources to conduct their own credit risk assessment, or to access and analyse data from different public and private data sources. Smaller investors seem to rely more heavily on credit ratings by credit rating agencies. They carry out their own additional assessment on an ad hoc basis, often linked to current events. Furthermore, these smaller investors outlined

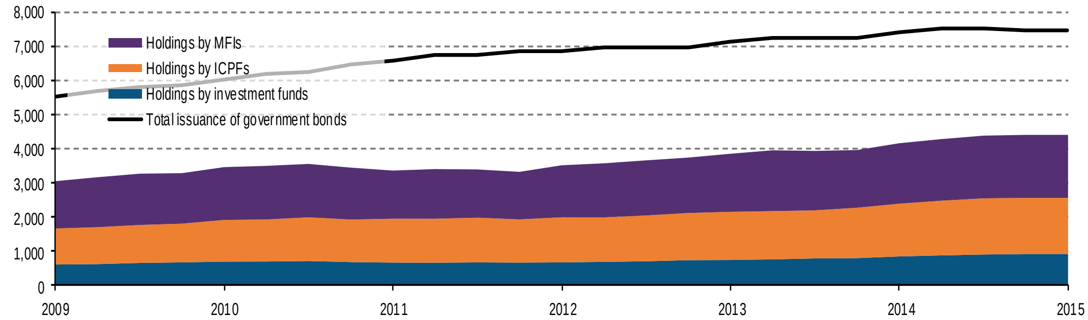
[21] Composed of pension funds, credit institutions and asset managers;

that the information on creditworthiness assessment of sovereign debt is not only used for investments in sovereign bonds, but also for other investment decisions and asset allocation which could be of relevance for small investors.

B) Market situation of sovereign bond holdings

In terms of market impact, domestic institutional investors represent a large portion of holdings in euro area sovereign debt. As shown in Chart 5, in particular resident monetary financial institutions (MFI's), insurance corporations and pension funds (ICPF's) and investment funds represent an important share of the investments in euro area government bonds.

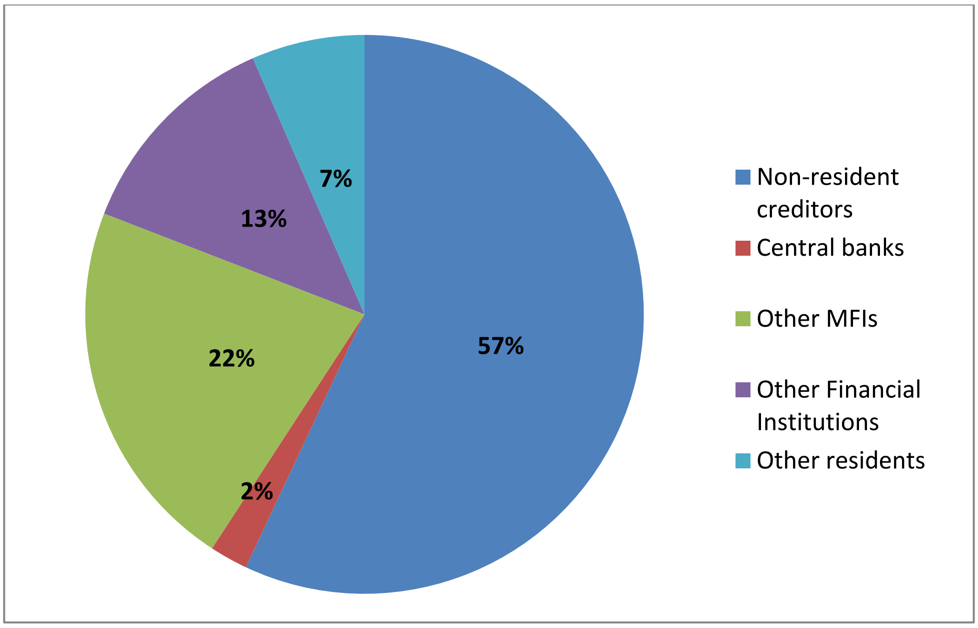
Chart 5: Issuance and holdings of sovereign bonds, euro area, € billion



Source: ECB and own calculations

As demonstrated in Chart 6, in 2013, Euro area, non-institutional resident investors accounted for 7.2 percent of total holdings in euro area sovereign bonds. Consequently, these investors represent only a small share of investment in sovereign bonds. In addition, non-resident creditors represent 57 percent of investment in sovereign bonds in the EU. This includes both investors from other Member States and from outside the EU.

Chart 6: Holdings of sovereign bonds by type of investor, 2013, percentage of total government debt, European Union



Source: ECB, Government Finance Statistics, own calculations

2. Information available to investors

A wide range of information on sovereign debt is available to market participants through both public and private channels. This provides input for investors to carry out their own credit risk assessment. Information from public sources is published by Member States themselves, European Institutions as well as various international organisations. In addition, a number of private providers supply information to investors. This includes specialised data providers, trade associations and CRAs. The type of information provided, the frequency and the nations covered varies widely depending on the information channel.

3. Information provided by the European Commission

At EU level a wide range of statistics and reports on the economic situation of and economic developments within Member States has been publicly available for some time. The Commission publishes government debt data, quarterly government finance statistics and data reported under the Excessive Deficit Procedure (EDP) in a harmonised and comparable way. Furthermore, the Commission publishes economic forecasts, euro area, public finances and fiscal sustainability reports. The introduction of new European rules on fiscal and macro-economic surveillance within the European semester, together with reinforced requirements for Members States' reporting on government finance statistics under the European System of National and Regional Accounts (ESA 2010)[22] strengthened the information available to investors to assess the creditworthiness of EU sovereigns.

[22] Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union, OJ L 174, 26.6.2013, p. 1.

A) Enhanced fiscal and macro-economic surveillance of Member States

At EU level, the rules governing the Stability and Growth Pact[23] (hereafter referred to as the Pact) are the cornerstone of the EU's economic governance and aim to ensure the proper functioning of Economic and Monetary Union. The main objective of the Pact is to promote sound budgetary policies and to ensure the sustainability of public finances in the Member States.

In recent years, the Pact was strengthened to address shortcomings in economic governance and budgetary surveillance and to improve the monitoring of the macro-economic and fiscal performance of all EU Member States in general and of the euro area in particular. Following these initiatives, investors have access to additional information for their own assessment of the state of public finances.

The reinforced European Semester of economic policy coordination and the six legal acts known as the 'Six-Pack'[24], adopted in November 2011, strengthened the Stability and Growth Pact (SGP). As part of the European Semester, the Commission analyses national plans of budgetary, macro-economic and structural reforms and, on that basis, the Council adopts targeted recommendations addressed to each Member State. Furthermore, a system of financial sanctions kicks-in for the Euro area Member States in case of excessive macroeconomic imbalances and/or budgetary deficits.

In the context of the European Semester[25], a number of reports are published wherein the Commission takes stock of the macro-economic and budgetary situation of all Member States. These include:

> 1) The Annual Growth Survey (November) which sets out the EU priorities to boost growth and job creation;
>
> 2) The Alert Mechanism Report in the context of the Macroeconomic Imbalance Procedure, which based on a scoreboard of indicators, identifies the Member States that require further analysis;
>
> 3) The Country Reports (February/May), in which the Commission publishes a single analytical economic assessment per Member State evaluating their economic situation, their reform agendas and whenever deemed relevant on the basis of the Alert Mechanism Report and the possible imbalances faced by the Member State. For several Member States identified in a scoreboard, an in-depth

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23 The Pact is anchored in the Treaty on the Functioning of the EU (TFEU) and consists of Council Regulation (EC) No 1466/97 (the "preventive arm", based on Art. 121 TFEU) and Council Regulation (EC) No 1467/97 (the "corrective arm", based on Art. 126 TFEU), as well as their subsequent amendments and related legislation.

24 The six-pack is a set of five Regulations and one Directive which entered into force on 13 December 2011 and covers fiscal surveillance and macroeconomic surveillance under the new Macroeconomic Imbalance Procedure.

25 An overview of the stages in the European Semester can be found at: http://ec.europa.eu/economy_finance/economic_governance/the_european_semester/index_en.htm

review is conducted. This review includes an assessment of the public and/or private indebtedness in view of the future evolution and cost of borrowing; and

4) Country-specific recommendations (May) are then proposed by the Commission, for adoption by the Council; they provide tailor-made policy advice to Member States in areas deemed as priorities for the next 12-18 months. The recommendations are accompanied by an assessment of the Member State's Stability and Convergence Programmes.

For the euro area, an additional mechanism was put in place. This reform package, the so-called 'Two-Pack'[26], has been in force since May 2013 in all euro area Member States and further increased the transparency on euro area Member States' budgetary decisions and improved the coordination of Member States' debt issuance plans.

To ensure the coordination of fiscal policies among Member States sharing the euro as their currency, governments (except for countries under a macro-economic adjustment programme) are also required by the Two Pack to submit their draft budgetary plans for the following year to the Commission by the 15th of October each year[27]. The Commission provides two assessments of the draft budgetary plans: an opinion on each Member State's plan and an overall assessment of the budgetary situation and prospects of the euro area as a whole.

The opinion on the draft budgetary plan of each euro area Member State is based on the assessment of compliance with the SGP and it is built on the Commission's autumn forecast. If the Commission finds that a Member State's draft budgetary plan is in particularly serious non-compliance with its SGP obligations, it can ask for a revised draft to be submitted.

All European Semester related information is public. Hence, this provides investors with timely and periodic information, based on a common methodology. It complements the information already disclosed to the public by Member States' national statistical offices, national debt agencies and private information providers.

The European Semester has streamlined the information flows available to investors. This allows them to have a better view of the macro-economic and fiscal performance of Members States. It also provides them with an additional information source and with the raw data to conduct their own credit risk assessment of sovereigns.

In addition, some other tools have been developed at EU level to assess macro-prudential strengths of Member States. For example, the Directorate General for Economic and

[26] Two Pack, which consists of 2 Regulations which introduced additional surveillance and monitoring procedures for euro area Member States.

[27] These draft plans are made public by the Commission in accordance with Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, OJ L 140, 27.5.2013, p. 11.

Financial Affairs (DG ECFIN) has developed an early-detection index of fiscal stress for EU countries.

Furthermore, every 3 years, the Commission publishes Ageing Reports which assess the economic impact of demographic changes. These are complemented by reports on the fiscal sustainability of public finances in the Member States, against the background of financial, economic and fiscal impact of the demographic changes.

B) ESA 2010

With effect from September 2014, the ESA 2010 has replaced ESA 1995[28]. ESA 2010 clarifies the definitions and rules regarding Government Finance Statistics (GFS), thereby enhancing the accuracy and comparability of such statistics.

ESA 2010 defines and regulates Member States' reporting of information on government debt and clarifies the reporting requirements for and treatment of some specific financial transactions such as contingent liabilities, Public Private Partnerships and the use of Special Purpose Vehicles which previously were not always reported in the same way by Member States in the context of the GFS. As a result, the statistics collected on the GFS provide for a comprehensive view of the outstanding government debt of EU Member States. This allows investors to have accurate information on the state of the debt levels across the EU.

4. Conclusion on the supply and demand of information on sovereign creditworthiness assessment.

Based on the analysis above, a wide range of information is available for investors to assess the creditworthiness of EU sovereign debt. In particular, the European Commission publishes a wide range of information on European member states. This was recently strengthened due to the new rules on fiscal and macro-economic surveillance of the Member States. Based on the interviews conducted with a sample of investors, as described in the section above, no material gap could be identified between the information published and the information used or requested by financial market participants, for the purpose of assessing creditworthiness.

V. Appropriateness of the development of a European creditworthiness assessment for sovereign debt

A potential European creditworthiness assessment of sovereign debt could achieve a number of objectives and fulfil a number of conditions to be considered appropriate and proportionate. It should contribute to reducing over-reliance on external credit ratings when assessing sovereign debt. Furthermore, it should improve the situation on the market in terms of information sources available to stakeholders to assess creditworthiness of sovereigns. In addition, to determine if a European creditworthiness assessment of sovereign debt would be appropriate, the potential scope and mandate as

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[28] Council Regulation (EC) No 2223/96 of 25 June 1996 on the European system of national and regional accounts in the Community, OJ L 310, 30.11.1996, p.1.

well as the potential economic impact of any such system on stakeholders, including investors, issuers, the rating industry and the taxpayers should be considered.

1. Typology of a potential European creditworthiness assessment for sovereign debt

A European creditworthiness assessment of sovereign debt could be conceived in multiple forms and with different objectives. The scope can be determined in terms of information (being quantitative or qualitative information) on which it is based and the level and robustness of the assessment provided to investors.

A) Scope of the assessment

An EU creditworthiness assessment could entail that a European public body would publish economic indicators and research reports with a quantitative and qualitative assessment of EU Sovereigns. These reports would provide an alternative source of information, though without a single indicator, as the one employed by CRAs.

In a restrictive sense, it could be defined as a European public body which would conduct an assessment of the creditworthiness of European Union Member States based on a set of quantitative data on EU Member States and publish periodically the changes of this quantitative data. This would provide an alternative source of quantitative information on the creditworthiness of sovereigns compared to the existing credit rating agencies.

B) Governance of a European creditworthiness assessment

For any European assessment to be considered by market participants as a credible measure of creditworthiness, it is necessary that it would be carried out by a credible and reputable body, either an existing entity or a new body.

The task could be entrusted to existing EU institutions, bodies or agencies or to a new public body to be established. For any existing body it should be considered that a new task would not affect the effective implementation of their current mandate. With regard to the European Commission, a largely similar assessment is already conducted within the current framework of economic and fiscal surveillance of Member States which includes quantitative and qualitative assessments of EU Member States.

C) Costs

The various options set out above for a possible European creditworthiness assessment would have differing, yet important, consequences for the determination of resources the assessment would need to be set up and the potential impact it would have on the market.

In particular, the creation of a new body would entail important set-up costs which should be weighed up against the potential benefits for the EU sovereign bond market and the European economy as a whole. The Commission has already estimated in the past the potential costs that such an exercise would entail, and concluded that this is disproportionate to the benefits generated[29]. In particular, in so far a new body would

[29] SEC(2011) 1354, Impact assessment, accompanying proposal for a Regulation amending Regulation (EC) No 1060/2009 on credit rating agencies, p. 34-37

merely duplicate the information provided on EU sovereigns by existing EU institutions, the benefits would most likely not outweigh the costs.

2. Impact of a European creditworthiness assessment

A) Impact on reliance on sovereign credit ratings

If a potential European creditworthiness assessment would constitute an alternative to external ratings, this could reduce reliance on such ratings. A potential European creditworthiness assessment should be complementary to existing information sources and avoid that it would be solely and mechanistically relied upon by investors.

The report[30] of the Financial Stability Board on the implementation of the FSB principles on reducing reliance to ratings, calls on authorities to "*guard against the temptation to adopt a small number of alternative measures for assessing creditworthiness in place of CRA ratings, which can result in substituted pro-cyclicality and herd behaviour*."

To the extent that it would duplicate the existing information provided by the current macro-economic surveillance of European sovereigns, it can be expected that the impact on reducing over-reliance on external credit ratings would be limited.

B) Impact on investors

A European creditworthiness assessment would have a distinct impact depending on the type of investor.

Based on interviews carried out with a sample of institutional investors, the benefits would be limited, as they already carry out an in-depth creditworthiness assessment based on the existing data sources. The existing fiscal and macro-economic surveillance regime already provides all relevant information to assess the creditworthiness of EU sovereigns. A European creditworthiness assessment would merely provide an additional input into their credit risk assessment system. Furthermore, the interviewed institutional investors investing in the global sovereign bond market favour comparable data on a global level, not limited to a geographical area such as the EU. Such information is already provided by international institutions such as the International Monetary Fund (IMF)[31], the World Bank[32] and the Organisation for Economic Cooperation and Development (OECD)[33].

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30 Financial Stability Board, Thematic Review on FSB Principles for Reducing Reliance on CRA Ratings, available at: http://www.financialstabilityboard.org/wp-content/uploads/r_140512.pdf.

31 For example IMF country reports available at: http://www.imf.org/external/country/index.htm; Other IMF global statistics on key economic aggregates which can be employed for creditworthiness assessment of sovereigns are available at: http://www.imf.org/external/data.htm.

32 For example world bank sovereign debt statistics available at: http://data.worldbank.org/data-catalog/international-debt-statistics;

33 For example the OECD economic outlook, available at http://www.oecd.org/eco/economicoutlook.htm and the OECD research and statistics on public finance and Sovereign debt, available at http://www.oecd.org/eco/public-finance/

Based on interviews with smaller investors, they could, in some circumstances, benefit from an EU creditworthiness assessment if it could reduce the efforts to gather and analyse all available relevant information. While they benefit from the transparency provided by the new fiscal and macro-economic surveillance regime with the EU, they have limited capabilities to process this information.

However, in the current setting, a European creditworthiness assessment would add little additional value to the existing information provided by the fiscal and macro-economic surveillance regime, in particular compared to the costs associated with the set-up of any such European assessment.

C) Impact on competition in the rating industry

A genuine European creditworthiness assessment could create a new public competitor to the existing public and private information sources. It would indirectly challenge the existing CRAs and compete against existing private aggregators of information available to investors. Furthermore, it would provide an alternative for some of the economic research on European sovereigns conducted by international public institutions such as the IMF, the World Bank and the OECD.

3. Conclusion on the appropriateness of an EU creditworthiness assessment

A European creditworthiness assessment would have only limited impact on the efforts to reduce reliance on sovereign debt ratings as it would, most likely, duplicate existing information. Furthermore, if not managed correctly, it could entail the risk of creating over-reliance on a new alternative if relied upon by investors in an exclusive way.

In addition, based on interviews with a selection of investors, a European creditworthiness assessment would not materially improve the level of information for institutional investors. These investors have sufficient information available through private and public sources. This has been further improved through the new system of fiscal and macro-economic surveillance of Member States within the European semester. For smaller investors, who also benefit from the surveillance mechanism, a European creditworthiness assessment facility could provide some benefits by reducing the research efforts. However, their inherent capabilities with such information tool are limited. Finally, a European creditworthiness assessment would compete with existing private information providers including credit rating agencies.

Combining all relevant factors, a European creditworthiness assessment for sovereign debt seems neither proportionate nor appropriate at this stage, when analysed next to the needs of investors and the objective of eliminating over-reliance on external credit ratings. As such, the Commission will not pursue the implementation and development of such a European creditworthiness assessment for sovereign debt. However, the Commission will continue to explore the possible alternative sources of easily available information to address the needs of smaller investors, as explained in the following section.

VI. Alternative actions

In spite of the wide dissemination by the European Commission of economic and fiscal data on European Member States, smaller investors might face difficulties in assessing the creditworthiness of sovereign debt due to their limited capabilities to process this information. To address this, other measures could be envisaged, focusing on the flow of underlying information needed to assess creditworthiness.

The Commission will reflect further on the following measures:

1. Incorporating international transparency standards

Firstly, the implementation by the Member States of international best practices on reporting of sovereign debt and debt issuances could be considered. An enhanced level of harmonisation based on international standards could reduce remaining differences in publication practices by Member States. This could improve the overall information flows on sovereign debt and debt issuance available to investors. Any such action would have to complement, rather than duplicate, the existing legal framework of statistical data reporting by Member States to instances such as EUROSTAT. Once finalised, the findings of the OECD Task Force on Transparency of Debt Statistics, Debt Operations and Public Debt Policies[34] could provide a basis for this analysis.

2. Furthering best practices by the Member States

Secondly, the Commission will explore whether best practices observed in some Member States can be exported to all other Member States, to enable better access to national public debt data. For example, some Member States publish dedicated national databases with detailed information on their outstanding public debt. These databases are easily and freely accessible to all investors and interested parties.

3. Streamlining publication of data by the Commission

Finally, information on economic performance and demographics is available at EU level and is published by the Commission through various webpages and databases. The Commission could explore streamlining how and where existing data, reported by Member States, is made available to the public.

[34] Hans J. Blommestein, Fatos Koc and Thomas Olofsson (eds.), (Forthcoming 2015), Recommendations on the Transparency of Debt Statistics, Debt Operations and Public Debt Policies, OECD Publishing,