



## **BOOK REVIEW**

### **THE GOVERNANCE OF CREDIT RATING AGENCIES: REGULATORY REGIMES AND LIABILITY ISSUES**

*by Andrea Miglionico, Edward Elgar, 2019, 360 pp., ISBN 9781786439932*

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The reviewed book is written by Dr. Andrea Miglionico, a young and promising academic who has multiple degrees in law including two doctoral degrees in law. Credit rating agencies (CRAs) play a key role in the securities market as their rating is considered trustworthy among investors, regulators and other industry stakeholders. CRA ratings importance was elevated when the Bank for International Settlement (BIS) in its Basel II accord endorsed the External Credit Assessment Institutions (ECAIs) credit rating while computing bank capital adequacy under the Standardized approach. However, CRA ratings reliability was highly criticized by academics and industry insiders after the financial crisis of 2007-08 and Europe sovereign debt crisis in 2011-12. Within this global context, Miglionico in his book chiefly addresses two central issues under two major research questions: (1) what are the CRA regulations in developed economies (The US, EU, UK)? and (2) what liabilities are addressed to the CRAs in these regulations? This is the uniqueness of the book which addressed the contemporary issues in financial economics and law. It has four parts with eleven chapters on the CRA business model, CRA regulation, CRA accountability and the final findings by the author.

It is arguable whether credit rating agencies act as quasi-regulators or not; however, the ‘Gatekeeper’ role of CRAs was criticized before and after the financial crisis of 2007 by several academicians such as Partnoy (1999, 2006, 2017), Coffee (2006), and Darbellay (2013). In the first part of the book, the author distilled all past academic debate into five broad categories, namely (i) effectiveness of CRA rating methodologies in the real world, (ii) the conflict of interest arising from the CRA revenue model, (iii) how

insufficient disclosures create a gray zone for investors, (iv) importance of competition in the CRA business, and (v) how the ‘rating trigger’ deepened the financial crisis in 2007-08. In addition, the author raised doubt on ECAs rating reliability and shed light on banking regulators.

The second part of the book describes the CRA regulatory framework in the investigated countries. It starts with IOSCO, which is the global body of the Securities and Exchange Commission, which published guidelines on ethical conduct for CRAs in 2004, 2009 and 2013. The author, however, mentioned those conduct as ‘soft law approach’ because IOSCO has no regulatory power indeed. On the other hand, in the US capital market, CRAs have played a significant role in securities regulation since the 1970s and the CRA industry was highly restricted by creating the ‘Nationally Recognized Statistical Rating Organization’ (NRSRO) status and it was controlled by big three CRAs for long decades. In the academic circle, Partnoy (1999) highlighted the ill impact of regulatory uses of CRA rating and got noticed by US regulators. Consequently, the US Securities and Exchange Commission has responded to the Partnoy (1999, 2006) concerns regarding CRAs role in financial market regulation. ‘The CRA Reform Act 2006’, ‘Dodd-Frank Act 2010’ and various reforms in the NRSRO designation and authorization process are the outcomes of this response. The European Union including UK response to CRA regulation gained momentum after the 2007 crisis and addressed the issue by adopting new regulation on CRAs. In this part, the author noted that although updated over the years, the CRA regulations failed to address the civil liability of CRAs for irresponsible or inaccurate ratings, which is the main legal drawback within the regulation.

In the third part of the book, encompassing four chapters, Miglionico explores extensively the CRAs current liability position in the UK, the US, EU and Australia which makes the book a unique contribution to the field of banking regulation in several ways. First, he discusses the CRA liabilities in the United Kingdom by thorough review of English cases on tort law and to focus on ‘liability of negligence’ and ‘doctrine of Estoppel’ in the CRA case. Second, the author tries to focus on the United States regulatory protection to the CRAs through first amendment regarding the credibility of rating reports. At this point, he mentioned that by utilizing the amendment ‘CRAs successfully avoid the US lawsuits’ by considering their opinions as simply journalistic opinions (214). However, his discussion on the failure of the ‘Dodd-Frank Act’ to bring the CRAs omission under civil suits, seems to me coherent and more convincing. Third, although the CRA Regulation 2013 of the European Union

(EU) has shed some light on CRA civil liability it fails to harmonize it among the member states as the regulation leaves it up to each member state's national law. And finally, the author fine-tuned the Australian story while discussing the case of 'Bathurst Regional Council vs. Local Government Financial Services Pty Ltd' and argued that the Australian courts emphasize imposing a specific standard of liability on CRAs. In all these four chapters, the author demonstrates his command of illustrating the flaws of existing CRA regulation in developed economies. Indeed, this book can be considered as an authentic book on CRA regulation and banking regulation.

In the last part of the book, Miglionico offers two important constructive suggestions from his entire scholarly research. First, according to him, to avoid the conflicts of interest, CRAs should be regulated by an independent regulatory authority rather than the typical approach of 'rule by regulation'. He arguably presented his position while analyzing the CRA business model, CRA regulations and the liability regime in the CRA regulations. This is a comprehensive contribution of the book to the existing academic debate on credit rating agencies and their business model; that CRAs should be regulated by separate institutional bodies. Second, the regulators must reduce dependence on CRA ratings while financial market regulations and investors should also keep in mind while making investment decisions based on CRA ratings that the information CRAs provided is sometimes compromised by their business interests. At present, only a few books explore CRA regulation; this book, to a great extent, fills the gap in the literature.

## REFERENCES

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