



Date: 17 May 2010
Ref.: CESR/10-536

CONSULTATION PAPER

Guidance on the Enforcement Practices and Activities to be Conducted under Article 21.3(a) of the Regulation

Deadline for contributions: CESR invites responses to this consultation paper by **18 June 2010**. All contributions should be submitted online via CESR's website under the heading "Consultations" at www.cesr.eu. All contributions received will be published following the close of the consultation, unless the respondent requests their submission to be confidential.



Table of Contents

I. INTRODUCTION	3
1. Background	3
2. Purpose.....	3
II. GUIDANCE ON ENFORCEMENT PRACTICES.....	3
1. General remarks.....	3
2. Scope of the guidance	4
3. Enforcement practices as part of ongoing supervision.....	4
4. Interaction between competent authorities and CRAs.....	5
Appendix : Information requests and interaction with CRAs.....	7



I. INTRODUCTION

1. Background

1. The EU Regulation of the European Parliament and Council on Credit Rating Agencies (CRAs) was published in the Official Journal¹ on 17 November 2009 and came into force on 7 December 2009. As a result, CRAs operating in the EU will need to apply for registration between 7 June 2010 and 7 September 2010 for their ratings to be used for regulatory purposes in the European Community.
2. According to Article 21.3 (a) of the Regulation, CESR shall issue guidelines by 7 September 2010 on the enforcement practices and activities to be conducted by competent authorities under the Regulation.

2. Purpose

3. The purpose of this consultation document is to seek comments on the conclusions CESR has drawn for setting guidelines on enforcement practices applicable as part of ongoing supervision as well as on the interaction expected between CRAs and competent authorities.
4. The consultation period closes on 18 June 2010. Respondents are invited to send their comments via CESR's website (www.cesr.eu) under the section "Consultations". All responses that have not been labelled as confidential will be published on CESR's website. CESR will analyse the responses received and where appropriate revise its proposal accordingly.

II. GUIDANCE ON ENFORCEMENT PRACTICES

1. General remarks

5. This guidance sets out the typical information and data that competent authorities would expect to receive as part of their ongoing supervision of CRAs. It also outlines the level of interaction competent authorities expect to have with CRAs in the form of regular and ad-hoc meetings.
6. The CRA is responsible for demonstrating compliance with the requirements of the Regulation on an ongoing basis. Should a CRA believe that additional information would materially affect the conduct of ongoing supervisory activities, such additional information should be submitted.
7. It is important to note that this guidance is not exhaustive. Whilst it provides base guidance, it does not prohibit further information requests, onsite inspections or investigations where competent authorities deem necessary. Competent authorities may conduct onsite inspections or investigations themselves or through third parties (like audit companies).
8. In the case of specific investigations and as allowed under Article 23.3 of the Regulation, competent authorities are able to use their powers in relation to CRAs as well as any persons involved in credit rating activities, the rated entities, related third parties, or any other persons otherwise related or connected to CRAs or credit rating activities.
9. Requests for information may be made in a written format as well as verbally at any time.

¹ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0001:0031:EN:PDF>



10. It is important to note that this guidance may be altered to reflect the possible change in supervisory responsibility to the European Securities and Markets Authority (ESMA).

2. Scope of the guidance

11. Article 21.3 (a) states that guidance shall be issued on the enforcement practices and activities to be conducted by competent authorities under the Regulation. Whilst the term *enforcement* could be interpreted solely as the investigation measures that competent authorities could take in case of a potential breach by the supervised CRA or failure to comply with the requirements of the Regulation, it has a broader meaning under the terms of the Regulation. Enforcement does not only cover investigatory activities but also any practices and activities that supervisors may undertake to monitor CRAs on an ongoing basis. Where the ongoing monitoring discovers potential breaches of the Regulation, further investigation will be required, the scope of which will depend on the specific nature of the potential breach.
12. Guidelines on enforcement practices following potential breaches will however not be made publicly available.
13. This guidance does not aim to cover the level of information and interaction expected as part of the registration process. It will not cover either the supervisory measures or sanctions which can be exercised by competent authorities under Articles 24 and 25 of the Regulation. These will be dealt within a separate guidance which will not be publicly available.

3. Enforcement practices as part of ongoing supervision

14. Competent authorities will typically require CRAs to provide a set of standard information and data as part of ongoing supervision. This may include rating transactions, methodology changes but also activity reports, board minutes as well as any changes to the organisation.
15. Some information will be required on a regular basis as part of the competent authorities' ongoing supervisory obligations. Some other information will be required on an ad-hoc basis if significant issues arise or in the case of any potential breach of the Regulation.
16. The typical set of information competent authorities may request on an ongoing basis is outlined in appendix.
17. It is expected that operational data will be requested on a monthly basis and cover ratings updates (including withdrawals), new issuances, methodologies reviews, internal control reviews, financial data and information on staff turnover. Data on changes of location of lead analysts and outsourcing arrangements will also be required. Competent authorities will review how the CRA determines, discloses and maintains its location of issuance for each rating.
18. It is expected that compliance data will be requested on a monthly or quarterly basis, depending on the scale of the CRA business. These requests may include updated work plan, identification and mitigation of potential conflicts of interests or breaches, compliance reports as well as any internal audit or risk reports produced by the CRA. Board minutes may also be requested where relevant.
19. In addition to the information set out herein, the CRA should notify the competent authority of any material change to the documentation submitted as part of the registration process. A material change is any change that may affect the substance of the information submitted in the application for registration. In any event all changes that may affect compliance with the



requirements of the Regulation are material. Data and information on material changes shall be provided to competent authorities on an ad-hoc basis.

20. Although competent authorities may consider the scale and complexity of a CRA business in the conduct of their supervisory activities, the level of information required within this section will be prescriptive as it forms the basis of ongoing supervision. Each CRA can expect to be advised by supervisors of the necessary level of information it is expected to provide. CESR will seek to ensure that CRAs are treated in a consistent manner across colleges and through direct interaction with competent authorities as necessary.
21. Competent authorities retain the ability to request further information as part of their ongoing supervisory activities, as permitted under Article 23 of the Regulation.

Q1: Do you agree with the approach outlined in section 3? If not, please state your reasons.

4. Interaction between competent authorities and CRAs

22. Whilst the home competent authority remains the primary contact for CRAs, other competent authorities also expect to have a certain level of interaction with them as part of their supervisory obligations. A number of meetings may be organised by competent authorities in line with the work plan agreed by the college. These meetings will take place on a regular and ad-hoc basis with key staff in the relevant business units to give competent authorities a good understanding of how firms operate and an opportunity to investigate any specific areas that may present risks to the objectives of the Regulation.
23. On-site visits could involve any of the following:
- a. filling gaps in the information competent authorities already hold, including regular submissions they received, previous assessments, reviews of specific areas and other information supplied by CRAs;
 - b. following up issues that have been identified from previous work or information; and
 - c. undertaking some limited work to verify their views about certain aspects of the CRAs operational structure.
24. These regular visits could typically involve meetings with key individuals working for the CRA, including non-executive directors. The number of individuals that competent authorities would expect to see, and the time required overall for the on-site visits, will vary depending on the size and scope of the CRAs business as well as on the issues competent authorities may have identified in their preliminary work. However, examples and frequency of meetings that competent authorities may expect to have with CRAs at a subsidiary level but also at a global level, where feasible, include:
- a. Annual meeting with the Chairman and representatives of the administrative/supervisory board (including independent directors);
 - b. Annual meeting with the Chief Executive Officer;
 - c. Annual meeting with the Head of Internal Audit;
 - d. Six monthly meeting with the Head of Technology/IT;



- e. Six monthly meeting with the Credit Risk Officer;
 - f. Quarterly meeting with the Senior Management; and
 - g. Monthly meeting with the Compliance Chief Officer;
25. The number and frequency of meetings should be proportionate to the size and structure of a CRA, whether it is part of a Group, as well as on individual circumstances.
26. CRAs can expect to be given an advanced schedule of meetings that will highlight the key individuals that competent authorities will require to meet as well as a written agenda (nearer the time of the meeting) of the matters that competent authorities would like to discuss.
27. Whilst meetings will be arranged and led by the home competent authority, members of the college may attend where necessary and feasible.
28. As allowed by the Regulation, related third parties may be approached in the case of specific investigations.
29. Competent authorities retain the ability to request further meetings with any member of staff as part of their ongoing supervisory obligations or to deal with specific issues in the identified risk areas.
30. CESR will ensure consistency of approach across colleges and CRAs.

Q2: Do you agree with the approach outlined in section 4? If not, please state your reasons.

Appendix

Information requests and Interaction with CRAs

Collection of Periodic Information and ad-hoc Request	Supervisory Interaction ²
<i>This part of the guidance sets out the standard information and data regulators may require from CRAs as part of their ongoing supervision.</i>	<i>This part of the guidance sets out the <u>typical</u> expected interaction between regulators and the supervised CRAs. This may include details on the form, content and frequency of the meetings.</i>
The set of information required by regulators is expected to include:	Regulators should consider setting up regular as well as ad-hoc meetings with key staff, typically including:
<ol style="list-style-type: none"> 1. Operational data (monthly), <i>including</i>: <ol style="list-style-type: none"> a. ratings data (lists of new issues, rating transitions and reviews, withdrawals including links to related documentation; number of issuers/transactions rated/monitored and broken down by type of credit rating) b. methodologies' reviews including information on any backtesting performed in the period, the details of any key findings as well as actions taken by the CRA as a result. c. financial revenues and costs (including revenues generated by each type of credit ratings) d. staff turnover & promotion (including to the role of committee Chair or Person approving ratings), broken down by type of credit rating and seniority of analysts. e. description of any internal review performed on rating models and rating process. f. data on changes of location of lead analysts and outsourcing arrangements (where relevant). 2. Compliance data (monthly or quarterly), including: <ol style="list-style-type: none"> a. updated work plan b. compliance/internal audit/risk/internal review reports c. potential breaches and conflicts of interests identified and measures taken as a mitigant 	<ol style="list-style-type: none"> 1. Annual meeting with Chairman and representatives of the administrative/supervisory board (including independent directors) 2. Annual meeting with the Chief Executive Officer 3. Annual meeting with the Head of Internal Audit (where applicable) 4. Six monthly meeting with the Head of Technology/IT 5. Six monthly meeting with the Credit Risk Officer 6. Quarterly meeting with Senior Management on strategy and business plan 7. Monthly meeting with the Compliance Chief Officer 8. Ad-Hoc meetings to deal with specific issues in identified risk areas with any member of staff.

² As allowed by the Regulation, related third parties may be approached in the case of specific investigations. Furthermore, the number and frequency of meetings should be proportionate to the size and structure of a CRA, whether it is part of a Group, as well as on individual circumstances.



d. board minutes (where relevant)	
3. Data on material changes to the application since registration (ad-hoc)	