



European Securities and
Markets Authority

ESMA's Report on the Supervision of Credit Rating Agencies





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Acronyms used

CRA	Credit Rating Agency
CRA Regulation	Regulation No 1060/2009 as amended by the Regulation No 513/2011
ESMA	European Securities and Markets Authority
EU	European Union
IT	Information Technology
NCA	National Competent Authority
RC	Rating Committee
RTS	Regulatory Technical Standards

I. Introduction

1. This report provides an overview of ESMA's supervisory activity on Credit Rating Agencies (CRAs) registered in the European Union and summarises the results of ESMA's first examination of the three groups of registered CRAs (Fitch Ratings, Moody's Investors Services, and Standard & Poor's Rating Services).
2. The examination referred to in this document is the first step in an ongoing supervisory process conducted by ESMA and therefore does not represent a full scope investigation. The observations set forth in this Report refer to common issues affecting CRAs activities. As of the date of this document, ESMA has not determined whether any observation highlighted below constitutes a breach of the provisions of the Regulation. ESMA is still progressing in its assessment of the areas discussed in this Report. This Report is not based on a decision by ESMA's Board of Supervisors; therefore it is published without prejudice to the possibility of further investigations which could lead to enforcement or supervisory actions.

II. Background

3. CRAs play an important role in financial markets as their credit ratings are used by several market participants (investors, borrowers, issuers, governments) to form investment and financing decisions and consequently have a significant impact on the operation of financial markets and on the trust and confidence of investors and consumers.
4. Therefore, the European Parliament and the Council of the European Union agreed to lay down specific rules for CRAs operating in the EU, with the principal aim to protect investors and the stability of financial markets. The Regulation on CRAs was adopted in 2009 (Regulation No 1060/2009) and amended by the Regulation No 513/2011 (the combined regulations are now referred to as the "CRA Regulation").
5. The CRA Regulation introduces a common regulatory approach in order to ensure that credit rating activities are conducted in accordance with the principles of integrity, transparency, responsibility and good governance and that the resulting credit ratings are independent, objective and of adequate quality.
6. The CRA Regulation achieves its objectives by requiring CRAs to comply with a set of requirements which include the following subjects:
 - use of methodologies, that shall be rigorous, systematic, continuous and subject to validation;
 - appropriate disclosure to the public, with particular reference to the disclosure of methodologies that are used by CRAs and the presentation of ratings;
 - sound internal policies and procedures to prevent, identify, eliminate or manage and disclose any conflicts of interest; and
 - arrangements for sound corporate governance.

7. ESMA is the regulator of CRAs in the EU, exclusively responsible for the registration and ongoing supervision of CRAs. Specifically, ESMA is responsible for:
- the registration of CRAs that operate or intend to operate in the EU. Applications for registration received prior to 7 September 2010 continue to be dealt with by national competent authorities with the assistance of ESMA¹. New applications for registration will be directly assessed by ESMA. ESMA expects several new applications to be filed in 2012;
 - the ongoing supervision of registered CRAs, that is the monitoring of CRA compliance on a continuous basis with the CRA Regulation. In order to do so, ESMA has been granted supervisory powers, such as requesting relevant information, hearing of persons, examining records and conducting on-site inspections;
 - taking appropriate supervisory measures and imposing fines, in cases where ESMA discovers a breach of the CRA Regulation. Depending on the seriousness of the breach, such supervisory measures could range from the issuance of a public notice to the withdrawal of the registration;
 - submitting draft regulatory technical standards (RTS) for endorsement by the European Commission. In December 2011, ESMA submitted its RTS on: a) information to be provided by CRAs for applications for registration and certification, b) information provided by CRAs to ESMA through the CEREP platform², c) the assessment of the compliance of the rating methodologies, and d) the content and format of ratings data periodic reporting to be requested from CRAs for the purpose of ongoing supervision by ESMA; and
 - the assessment of third country regimes under the endorsement and certification provisions in the CRA Regulation³.

III. ESMA's examination

8. ESMA took over the supervisory competences in the field of CRAs in the EU on 1 July 2011. At that time, five CRAs had been already registered and one certified⁴, whereas several registration processes were still pending. In particular, the registration process of the larger CRAs was finalized by the relevant national competent authorities on 31 October 2011.

¹ According to the transitional measures envisaged in the CRA Regulation, the assessment of applications for registration received before 7 September 2010 must be finalised by the relevant national competent authority with a decision to register or refuse registration.

² CEREP is a Central Repository for publishing the rating activity statistics and rating performance statistics of credit rating agencies.

³ Article 4 (3) of the CRA Regulation provides that in order for a CRA to endorse a credit rating issued in a third country, the regulatory framework of the third country should set requirements "as stringent as" those provided by Articles 6 to 12 of the CRA Regulation. Moreover, Article 4(3) also requires that there is an appropriate cooperation arrangement between ESMA and the relevant competent authority of the credit rating agency established in the third country.

⁴ Certification is a specific regime introduced by the Regulation that can be used by small CRAs from third countries with no presence or affiliation in the Community to provide for the use of credit ratings issued in third countries in the EU, in case that these CRAs are not systemically important for the financial stability or integrity of the financial markets of one or more member states. Certification is possible after determination by the Commission of the equivalence of the legal and supervisory framework of a third country to the requirements of the CRA Regulation.

9. At the time of publication of this report, 12 single CRAs and 16 legal entities pertaining to three groups of CRAs (Fitch Ratings, Moody's Investors Services, and Standard & Poor's Rating Services) have been registered, for a total count of 28 registered legal entities. In addition one CRA has been certified⁵. Registered CRAs show different characteristics in terms of market relevance and type of activities carried out. In particular:
- registered CRAs are established in ten different EU Member States. However, only the three registered groups of CRAs and another single CRA have pan-European presence, whereas the rest of the registered CRAs are mostly active locally;
 - nearly all registered CRAs issue corporate ratings, six CRAs issue credit rating on sovereigns and public institutions and four CRAs (the three registered groups and another CRA) currently issue credit ratings on structured finance products⁶;
 - most of the CRAs not belonging to a group (single CRAs) are small-sized entities with less than 50 employees and approximately half of them have applied for one or more exemptions from the requirements of the CRA regulation (as permitted by Article 6(3) of the CRA Regulation); and
 - according to the data provided to ESMA by the CRAs through the CEREP platform, which is publicly available and can be consulted on ESMA's web page (<http://cerrep.esma.europa.eu>), ratings issued by the larger CRAs represent nearly 95% of the outstanding ratings issued by the CRAs registered in the EU.
10. ESMA considered it important to carry out an initial examination with the immediate aim of monitoring compliance with the Regulation and to better understand the business of the three large groups of registered CRAs. As one of the main objectives of the CRA Regulation is to protect investors and the stability of financial markets, ESMA decided to direct its first on-site examination to the most relevant players in the credit rating agencies sector.
11. The decision to conduct an initial examination of the three groups of registered CRAs soon after the conclusion of the registration process was also linked to the need to assess whether the procedural and organisational changes carried out by the CRAs during the registration process had been properly implemented and whether the new functions and procedures are properly embedded into the CRAs businesses.
12. ESMA made the decision to focus on three specific credit rating classes (sovereign ratings, bank ratings and covered bond ratings) which it considered to be significant, given the current market trends, the degree of credit linkage and the interdependence of these products. In November 2011, ESMA sent to the CRAs subject to the examination a formal request for information regarding rating actions on a sample of ratings from three different classes (banks, sovereigns and covered bonds). The information related to the period from 1 November 2010 to 31 October 2011. ESMA chose a one-year examination period in order to acquire a clearer picture of the functioning of the rating processes.
13. ESMA's sample included all rating actions occurring during the examination period regarding: the selected group of covered bonds, the banks which issued the bonds included in the sample and the

⁵ The list of registered and certified CRAs is available on ESMA's website (<http://www.esma.europa.eu/page/List-registered-and-certified-CRAs>).

⁶ In this context, Covered Bonds are considered part of structured finance products.

relevant sovereigns. In order to achieve consistent results, ESMA analysed the same sample of credit ratings in all the CRAs subject to examination. ESMA's request for information included: the staff resources dedicated to the above mentioned rating classes, the methodologies used for the rating decisions, the organisation and work of the review, compliance and internal audit functions, and the procedures regarding disclosure of rating actions and the presentation of ratings.

14. Following the request for information, ESMA's Staff conducted an on-site examination of the CRAs from 2 to 21 December 2011. The on-site examination focused on the rating process for the above mentioned products, taking into account all regulatory issues related to the core rating process. The examination mainly consisted of interviews with senior staff involved in the rating decisions (lead analysts, secondary analysts, chairs and members of the rating committees) and other related functions (senior representatives of the review function, compliance and internal audit).
15. Following the analysis of the information obtained in the course of the investigation, this report summarises ESMA's views on the activities conducted by the CRAs in the areas subject to the examination.
16. The issues described in this document are general observations that apply to a varying extent to all the CRAs subject to the examination. In addition to the issues discussed in the Report, ESMA has also communicated its observations relating to shortcomings identified and areas for improvement for each CRA on a confidential basis through individual reports.

IV. ESMA's views

IV.1 CRAs internal processes

Recording of internal meetings

17. The introduction of the new regulatory framework in the EU has required CRAs to increase the level of formalization of their activities, to follow more rigorous policies and procedures and to clearly allocate detailed roles and responsibilities to the staff.
18. One of the main purposes of the CRA Regulation itself is to enhance the quality of the ratings through an increase of the transparency of the rating activities ("*...*) *It is essential, therefore, that credit rating activities are conducted in accordance with the principles of integrity, transparency [...]*" - Recital n.1 of CRA Regulation). The transparency of the rating activity is strictly linked to transparency of CRAs' internal processes.
19. Although CRAs made an effort during the registration process to put in place policies and procedures in order to fully comply with the CRA Regulation, during the on-site examination ESMA noted that certain parts of CRAs' internal processes (i.e. Rating Committees and other key internal meetings) were not sufficiently recorded.
20. Some core elements of the rating process, in particular the outcome of voting within the rating committees and the reasons considered to support or depart from the initial proposals presented by the analysts, do not appear to be appropriately or systematically recorded. This raises concerns for the

adequate recording of the main elements of the committee's analytical discussions underlying each rating action.

21. Proper recording of the Rating Committee (RC) discussion, including the voting outcome, is necessary for CRAs so as to be able to provide evidence that the RC decision has been taken in accordance with the relevant internal policies and procedures and the relevant methodology. Moreover, an adequate recording of the RC meetings would facilitate the process of ensuring consistency of rating activities, as it allows CRAs to maintain an audit trail of the rationale for other rating decisions.
22. Proper recording of the RC discussions would allow the CRA to verify internally and to keep records of the fact that ratings are based on a "*thorough analysis of all the information that is available to it and that is relevant to its analysis according to its rating methodologies*", as required by Article 8(2) of the CRA Regulation.
23. CRAs should have a higher degree of formalisation and recording of its internal processes, in particular with reference to the activity of the RCs, in order to:
 - monitor whether the activities are performed in accordance with its internal policies and procedures;
 - demonstrate that its business is carried out in accordance with the requirements of the Regulation and, with specific reference to the credit rating process, to demonstrate that the credit ratings are based on a thorough analysis of all the information that is available (Article 8(2) of CRA Regulation);
 - ensure a consistent application of its rating methodologies, in accordance with the requirements of the Regulation (rigorous, systematic, continuous - Article 8(3) of the Regulation);
 - enhance the transparency as regards participation and decision making process within committees, including the selection of committee members;
 - perform its activities in compliance with the requirements of the Regulation, in particular regarding what is envisaged by recital n. 26 ("*Credit rating agencies should establish appropriate internal policies and procedures in relation to employees and other persons involved in the credit rating process in order to prevent, identify, eliminate or manage and disclose any conflicts of interest and ensure at all times the quality, integrity and thoroughness of the credit rating and review process. Such policies and procedures should, in particular, include the internal control mechanisms and compliance function*") and point 7 (e) of Annex I Section B ("*A credit rating agency shall arrange for adequate records and, where appropriate, audit trails of its credit rating activities to be kept. Those records shall include: [...]the internal records and files, including non-public information and work papers, used to form the basis of any credit rating decision taken*"); and
 - increase the efficiency and effectiveness of the interaction with the Regulator, thus facilitating the supervisory activity of ESMA .

Analysis of information

24. RC meetings are usually attended by participants who have not been directly involved in the evaluation of a specific rated entity. Indeed the number and diversity of attendees in RCs is a core element of the RC process to ensure the overall quality of the ratings.
25. In order to properly perform their role, RC members should be given an adequate period of time to analyse the relevant documentation which will be discussed during the meetings. However, ESMA noted that RC attendees had usually only a limited time to analyse the documentation which would be discussed in the meetings.
26. ESMA considers that a systematic short delivery period of the relevant documents under discussion does not allow for a thorough analysis of the documentation by the RC members and could undermine the potential added value which comes from the participation of people not directly involved in the rating analysis.

ESMA's views

Recording of internal meetings

In ESMA's view, CRAs should improve the recording of core internal processes, in particular regarding the activities of the Rating Committees. A more rigorous approach to the organisation and recording of Rating Committees and other key internal meetings and committees (i.e. relating to control functions, business lines management meetings etc...) would lead to improved control mechanisms for monitoring the quality and consistency of internal decisions, in particular relating to the rating activities.

Further formalisation should also be achieved in order to enhance rigorousness and transparency as regards participation and decision making within key internal meetings and committees, including selection of committees' members (chair and voting and non-voting members).

Analysis of information

CRAs should ensure that the documentation is distributed in a timely manner to allow RC members to prepare in advance, so as to ensure that the RC decision is based on a thorough analysis of all available information by all the RC members.

IV.2 Analytical Resources

27. The Regulation requires CRAs to allocate sufficient numbers of employees with appropriate knowledge and experience to its credit rating activities. In particular, CRAs should ensure that adequate human resources are allocated to the issuing, monitoring and updating of credit ratings (Recital n. 31 of Regulation No 1060/2009) and shall employ appropriate resources to ensure continuity and regularity in the performance of its credit rating activities (point A(8) of Annex I of CRA Regulation).
28. Analytical resources should reflect business development and market trends as well as the complexity of the relevant product in order to ensure the high quality of ratings and to avoid operational risk.

Against the background of the financial crisis, the workload for CRAs has significantly increased with regard to some specific rating classes.

29. ESMA noted a high staff turnover in one or more CRAs, notably in specific lines of business. CRAs demonstrated their efforts in increasing the number of employees and in improving retention rates. However, the quality of the output of the credit rating activity, could be undermined both by the limited number of resources and by the fact that new employees need time to acquire the proper knowledge of the CRAs internal process and of the peculiarities of specific asset classes. In this respect, ESMA is concerned that the quality of the ratings might be impaired by the lack of resources.

ESMA's views

ESMA considers that CRAs should monitor the adequacy of resources devoted to the analytical business lines on an ongoing basis in terms of number of employees and expertise, within the context of market developments and their impact on the organization.

IV.3 Governance and Control functions

30. The CRA Regulation encompasses a number of provisions requiring the establishment and functioning of different internal control mechanisms. The overall framework of the CRA Regulation relies on a sound presence of internal controls functions - namely Internal Audit, Compliance and the Internal Review function - and focuses on their accountability and independence.
31. Furthermore, the Regulation assigns specific duties to the Independent Directors, with the aim of enhancing oversight of the independence of the rating process.
32. The organisation and empowerment of some of these functions was one of the most important adjustments that the CRAs have carried out during the registration process in order to comply with the Regulation.
33. However, ESMA considers that in the case of one or more CRAs there is need to improve the role and tasks of the internal control functions and the Independent Directors, to enhance the effectiveness of their activities.

ESMA's views

In ESMA's view, CRAs should ensure that their internal control functions fulfil the duties conferred to them by the Regulation. Therefore, CRAs should:

- continuously monitor the adequacy of resources devoted to the control functions in terms of number of employees and expertise; and
- make sure that the relevant control functions effectively contribute to ensuring the consistent application of credit rating methodologies.

ESMA would expect the Independent Directors to continue developing their role and involvement in CRAs' activities and their interactions with internal control functions.

IV.4 Disclosure of Methodologies and presentation of ratings

34. In order for the users of credit ratings to make informed decisions, it is crucial that they understand how CRAs form or build their opinions. CRAs should be transparent vis-a-vis users with regard to the criteria they use and the method or system of methods they follow when forming their opinions. Indeed the CRA Regulation provides that "*A credit rating agency shall generally disclose[...]the methodologies, and descriptions of models and key rating assumptions such as mathematical or correlation assumptions used in its credit rating activities as well as their material changes*" (Section E, point I.5 of Annex I);
35. Moreover Recital n. 25 of the CRA Regulation states that "*Credit rating agencies should disclose information to the public on the methodologies, models and key rating assumptions which they use in their credit rating activities. The level of detail concerning the disclosure of information concerning models should be such as to give adequate information to the users of credit ratings in order to perform their own due diligence when assessing whether to rely or not on those credit ratings[...]*".
36. Finally Recital n. 34 of the CRA Regulation indicates that the description of the methodologies, models and key rating assumptions must be published "*in a manner permitting comprehensive review*".
37. Regarding the presentation of credit ratings, section D(2)(a) of Annex I of the CRA Regulation requires CRA to disclose for each rating "*all substantially material sources, including the rated entity or, where appropriate, a related third party, which were used to prepare the credit rating are indicated together with an indication as to whether the credit rating has been disclosed to that rated entity or its related third party and amended following that disclosure before being issued*";
38. Similarly, Section D(2)(b) of Annex I of the CRA Regulation requires that for each rating "*the principal methodology or version of methodology that was used in determining the rating is clearly indicated, with a reference to its comprehensive description; where the credit rating is based on more than one methodology, or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, the credit rating agency shall explain this fact in the credit rating and indicate how the different methodologies or these other aspects are taken into account in the credit rating*";
39. In recent years one or more CRAs have succeeded in compiling in a single document the different criteria governing a specific methodology, in order to enhance the transparency of their methodologies and to facilitate their use by investors. ESMA supports this attempt to increase the quality of the disclosure, which should contribute to a comprehensive and simple use of credit ratings in line with the requirements of the Regulation. Additionally, the methodologies published recently by one or more CRAs demonstrate a substantial improvement in the level of clarity and usability of the information, when compared to previous versions of such documents. Such an approach assists users of ratings with conducting their own due diligence and in recreating the steps that led the CRA to a specific credit rating decision.
40. However, ESMA also noted that in one or more CRAs the methodologies underlying credit rating decisions for some other products continued to be found in multiple documents, published in different periods and not easily identifiable on the CRAs web pages. This could prevent the user of the credit ratings from a clear understanding of the rationale of the relevant methodology and the key rating

assumptions underlying the credit ratings. Moreover, ESMA noted that the methodologies published by one or more CRAs on the rating categories in the selected sample, not always provide a clear and exhaustive overview of the criteria and models used and how these criteria contribute to the eventual rating decision.

41. Finally, ESMA notes that in one or more CRAs the process of elaboration and publication of press releases and other announcements of rating updates often contains a high degree of automation with only limited controls on the process. Considering the level of sensitivity accompanying certain rating actions, the process of publication requires careful attention. In addition, in one or more CRAs the updating of the website is often under the control and responsibility of the publication desks with only limited guidance or oversight provided by the analytical groups.

ESMA's views

In respect of the disclosure of methodologies and the presentation of ratings, in ESMA's opinion, CRAs should:

- aim at a the maximum level of transparency by disclosing all criteria on which the rating is based and by describing the method for adopting its decision; and
- ensure that the disclosure of rating methodologies is complete and comprehensive, and that, as far as possible, all relevant (including complementary) criteria are compiled in a single document setting forth the main methodology.

In addition, ESMA is of the opinion that CRAs should make all reasonable efforts to ensure adherence to rigorous procedures for the disclosure of rating actions, defining clear roles and responsibilities relating, in particular, to the controls to be performed prior to public announcements on the content, form and timing of the disclosure. More specifically, adequate attention should be placed on each step of the publication process so as to avoid the risks potentially linked to overreliance on purely automatic mechanisms.

IV.5 IT systems

42. While a review of the adequacy of the IT infrastructure was beyond the scope of the on-site examination conducted, ESMA observed that one or more CRAs are currently facing a number of challenges to the IT infrastructure supporting their core activities.
43. Information systems play a critical role within CRAs businesses. Factors such as globalization, new product developments and outsourcing have led to increased challenges to CRAs' IT environment. Equally, new regulatory requirements have added additional demands from an IT perspective.
44. Adequate IT systems and IT controls are therefore key elements to handle a CRA's activity smoothly, effectively and in compliance with the Regulation. Additionally, a robust IT infrastructure is fundamental in reducing and preventing operational risks which may be faced by the CRA.
45. The importance of a robust IT infrastructure and of an effective control environment over IT systems is described in several provisions of the CRA Regulation.

46. In particular, the Regulation requires that "*a credit rating agency shall employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of its credit rating activities*" (Annex I, Section A (8)) and that "*a credit rating agency shall have sound administrative and accounting procedures, internal control mechanisms, effective procedures for risk assessment, and effective control and safeguard arrangements for information processing systems*" (Annex I, Section A (4)). Finally, Annex I, Section A(10) requires a CRA to "*monitor and evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with this regulation and take appropriate measures to address any deficiencies*".
47. In recent years CRAs have experienced significant changes to their structure and internal organisation. The continuous increase in the business size, the consolidation or increase of their international presence and the introduction of new products and services forced CRAs IT environment to continuously adapt to their businesses.
48. New projects have usually required new data to flow down to multiple existing product systems or have required the integration of different systems with that data eventually being published on CRAs' websites or disseminated through other means. Moreover the introduction of new services has often required cross department coordination and development, both from an organizational and from an IT point of view.
49. As a consequence of such developments, CRAs have built different IT systems (local systems in the case of the integration of "geographical" IT systems or product systems in the case of the introduction of new services and products) and their integration has proved to be challenging.
50. Additionally the use of companies' web sites as the main vehicles for the dissemination of ratings and the provision of other services has greatly increased the critical nature of such means. Therefore there is an enhanced risk of errors due to the amount of the information delivered through the web site and increasing the disruptive effect of a potential error due to the importance and the relevance of the information disseminated via the internet.
51. Regulatory changes, both in the US and in the EU, have driven significant changes in CRAs' IT systems (for example EU Endorsement, EU solicitation status, monitoring of analyst rotation or the 12 hour rule), since new regulatory requirements have required both the capturing of new data and the implementation of new system controls in the rating process.
52. Finally, in the case of one or more CRAs the increase of IT workload has prompted an extensive use of external services providers and recourse to outsourcing agreements. Whilst such solutions have allowed CRAs to manage their IT requirements in a flexible manner, they have equally brought new risks associated with the use of external professionals, which raises issues of confidentiality of information, creating additional requirements in terms of capability to control the activity of the outsourcers.
53. All the above mentioned situations increase significantly the risks that a CRA faces regarding the adequacy of its IT systems. The integration of different systems, the merger of different IT environments or the upgrade of old IT systems and the creation of new business and IT processes shall be carefully managed by CRAs in order to avoid operational risks and potential breaches of the Regulation.

54. In such an environment, the presence of adequate IT control systems becomes more and more important.
55. The traditional approach to IT risk and controls over IT systems usually focuses on the security of the data in terms of back-up policies (disaster recovery plan) and the appropriateness of the access policies. In a developing environment it is equally important to test and control that changes and implementations in IT systems are properly carried out. Therefore CRAs shall continuously monitor the new IT systems that are put in place and the transition from old systems to new ones (or the merger of different systems) in order to avoid overlaps of systems and gaps or loss of information.

ESMA's views

CRAs should put in place adequate measures to ensure that the IT environment is properly managed and controlled by:

- ensuring that IT audit activity is adequate in terms of the scope and type of activity which is performed. In particular, ESMA recommends that CRAs not only focus their IT controls and review on the security aspects of their IT systems but also on the appropriateness and soundness of the transitional phases (new systems, replacement of old systems);
- ensuring that the IT audit activity is appropriately implemented in the European legal entities; and
- ensuring adequate controls over the systems and procedures that are related to the disclosure of the ratings on the company website.

V. Next steps

56. In addition to the general observations summarised in this report, ESMA communicated individual observations to the CRAs concerned which provide relevant information for this year's supervisory work. It is clear that ESMA will follow-up on the observations through risk mitigation plans for each individual CRA in the first half of 2012. Furthermore, the general and individual observations feed into ESMA's internal risk assessment which provides the basis for the supervisory work plans at an individual firm level. In this respect, reference is also made to the Regulation which stipulates that ESMA shall conduct at least one verification of all credit rating agencies falling under its supervisory competences by 1 July 2014 (Article 40a).
57. Additionally, ESMA intends to select one or more supervisory projects with a focus on certain cross-cutting risks within CRAs (cf. first step examination regarding specific rating categories). These will take the form of thematic reviews and will cover a selected number of CRAs during a limited period of time in which the examination takes place. Thematic reviews in 2012 may include the application of Article 8(3) of the CRA Regulation (which requires rigorous, continuous and systematic rating methodologies) and a thorough analysis of the control functions (compliance, internal review function, and internal audit) in certain CRAs. In case these reviews require specific expertise, ESMA might ask for the assistance of the relevant national competent authority.
58. The identification of these thematic reviews is also supported by the internal risk function which is based on various information sources, including: i) market intelligence by the CRA Unit and other departments within ESMA; ii) CEREP and the periodic reporting of data by CRAs to ESMA (in the near

future through the specific reporting system envisaged by the relevant RTS); iii) the registration process; iv) the exchange of information and cooperation with EU competent authorities and other non-EU authorities.

59. Finally, ESMA will continue to carry out the following activities, as part of its ongoing supervisory tasks:
- a. CRAs are required to inform ESMA about any material change to the initial conditions for their registration. For each registered CRA, ESMA will monitor any relevant change occurring after the registration and will decide to conduct specific examinations, if deemed appropriate.
 - b. According to ESMA's procedures, every complaint requires a formal response. ESMA will handle the complaints and may decide to further investigate the matter. In case the handling of the complaint requires specific local expertise, ESMA might ask for the assistance of the relevant national competent authority.
 - c. ESMA monitors the periodic reporting by each registered CRA. This information will be used for the individual risk assessment of the respective CRA. The individual risk assessment is also fed by the general risk analysis function within ESMA.

VI. Conclusion

60. This report provides the results of ESMA's first examination on the three groups of registered CRAs. ESMA has identified several shortcomings and areas for improvement in CRAs internal policies and procedures and addressed specific recommendations to the CRAs in the following areas:
- recording of internal meetings;
 - timing of the distribution of documents ahead of Rating Committees;
 - adequacy of resources devoted to the analytical business;
 - internal control functions and Independent Directors;
 - disclosure of rating methodologies;
 - process for the disclosure of ratings actions; and
 - IT environment.
61. As of the date of this document, ESMA has not determined whether any of the observations constitutes a breach of the provisions of the Regulation. ESMA will follow-up on the observations related to the individual CRAs in the first half of 2012.