

PRESS RELEASE

ESMA identifies deficiencies in CRAs sovereign ratings processes

The European Securities and Markets Authority (ESMA) has published a [Report](#) identifying a number of deficiencies in the processes for producing and issuing sovereign ratings at the three largest credit rating agencies (CRAs), Fitch Ratings, Moody's Investors Service and Standard & Poor's.

The Report follows an investigation carried out by ESMA into the sovereign rating processes at the three CRAs, between February and October 2013. The investigation was prompted by concerns about potential conflicts of interests, the impact of sovereign ratings on other types of ratings, CRAs' capacity to cope with the number of rating actions during a period of high volatility, the use of *bulk rating actions*, and issues around the confidentiality and timing of rating actions.

The investigation focused on the governance and organisation of sovereign rating activities, the adequacy and expertise of allocated human resources, the disclosure of rating information to the public, and ensuring its confidentiality before disclosure.

ESMA identified deficiencies and issues for improvement in the following areas:

- Independence and avoidance of conflicts of interests;
- Confidentiality of sovereign rating information;
- Timing of publication of rating actions; and
- Resources allocated to sovereign ratings.

ESMA has not determined whether any of the Report's findings constitute a breach of the CRA Regulation, and may take action as appropriate in due course.

Steven Maijoor, ESMA Chair, said:

“ESMA's investigation 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.

“The focus on the sovereign rating process in this investigation stems from their increased volatility over the past few years, the importance of sovereign ratings from a credit market and financial stability perspective, and their impact on other rated entities and products.

“The impact which changes in these ratings can have on financial markets, and sovereign states, can be significant. Therefore, it is imperative that users can have confidence that the CRAs have adequate systems and controls in place to ensure that ratings are rigorous, free from conflicts of interest and timely.

“The CRAs who were subject to this investigation still need to make improvements in their working practices to ensure their full compliance with the CRA Regulation and to eradicate inadequate practices from the past.”

Investigation Findings

The key areas where ESMA identified deficiencies requiring remedial actions by the CRAs included the following areas and related issues:

1. Independence and avoidance of conflicts of interests:

ESMA has concerns that in a number of areas associated with conflicts of interest and independence, the actual failings or potential risks identified might compromise the independence of the ratings process and the quality of the credit ratings. These include:

- the type of involvement of senior management in sovereign rating activities;
- the independent review function’s participation in the sovereign rating process;
- the research publication activities carried out by CRAs;
- the involvement by certain non-rating functions (e.g. communication) in the rating process; and
- the implementation of the appeal procedure.

2. Confidentiality of sovereign rating information

The investigation identified deficiencies in the way confidential rating information is managed, in particular how access to information on upcoming rating actions on sovereigns

is controlled. These include:

- the disclosure of upcoming rating actions to an unauthorised third party;
- inadequate controls in place for the circulation of rating information within the CRA(s);
- the controls around the use of external communication consultants; and
- inappropriate permissions and controls to secure access to rating information.

3. Timing of publication of rating actions:

The investigation found that there had been instances of significant and frequent delays in the publication of sovereign ratings. ESMA also observed deficiencies in the advance notification to rated entities about upcoming rating actions.

4. Resources allocated to sovereign ratings:

ESMA has concerns on the resources dedicated to sovereign ratings, in particular:

- the lack of an adequate mechanism to assess the adequacy of resources;
- assigning lead analyst responsibilities to junior or newly hired staff;
- reliance on junior support staff; and
- unclear definitions of functions and responsibilities.

A number of good practices were also identified amongst the surveyed firms including analytical training programmes, practices designed to improve challenge in rating committees, and to ensure continuity in the allocation of analysts to sovereign portfolios.

ESMA has required the CRAs to put in place remedial action plans to address the issues identified, and will monitor their progress against these plans as part of its on-going supervision.



Notes for editors

1. [2013/1775 Credit Rating Agencies – Sovereign Ratings Investigation](#).
2. [2013/87 ESMA 2013 CRA Supervision and Policy Work Plan](#).
3. ESMA is an independent EU Authority that was established on 1 January 2011 and works closely with the other European Supervisory Authorities responsible for banking (EBA), and insurance and occupational pensions (EIOPA), and the European Systemic Risk Board (ESRB).
4. ESMA's mission is to enhance the protection of investors and promote stable and well-functioning financial markets in the European Union (EU). As an independent institution, ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

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