

PRESS RELEASE

ESMA requires further improvements by CRAs

The European Securities and Markets Authority (ESMA) has published its second Annual Report on its supervision of credit rating agencies (CRAs) in the European Union.

The report summarises the supervisory work undertaken by ESMA, during 2012, in ensuring that CRAs complied with the CRA Regulation. The report includes details on ESMA's supervisory, registration, and policy work; and focuses on its investigation into bank rating methodologies and the follow up work to the March 2012 report on deficiencies in CRAs rating processes, governance and control mechanisms.

ESMA has identified progress by CRAs in their activities including improved disclosure of methodologies and ratings; internal control resources; involvement of senior management in governance and record-keeping practices. However, the report finds that CRAs have not sufficiently embedded the main requirements of the CRA Regulation in their organisations, and ESMA believes that improvements are still necessary in the following areas:

- the consistent application and comprehensive presentation of rating methodologies;
- the empowerment and resourcing of analytical and control functions;
- the monitoring and surveillance of ratings; and
- the reliability of IT infrastructures.

These issues will form the basis for much of ESMA's supervision activities as outlined in its 2013 Work Plan.

Steven Maijoor, ESMA Chair, said:

“ESMA, as the EU's supervisory authority for credit rating agencies, has a responsibility to ensure that these businesses meet the stringent criteria required of them under the CRA Regulation.

“While CRAs have made progress in meeting the regulatory requirements on integrity, transparency, responsibility and good governance, they have not sufficiently embedded in their organisations those changes necessary to address the concerns about the conflicts inherent in CRAs business models.

“Considering the continued importance of credit ratings in financial markets it is extremely important that CRAs identify and remedy those issues in their businesses which may undermine the independence, objectivity and the quality of credit ratings. This will contribute to building confidence in the transparency and smooth functioning of EU financial markets while ensuring a high level of financial consumer protection.”

Thematic Investigation – Bank Rating Methodologies

ESMA decided to focus on bank ratings due to their linkage with sovereign ratings, the number of methodological changes implemented over the period under investigation - September 2010 to August 2012 - and the significant rating activity in financials in the second half of 2011 and first half of 2012.

The bank rating methodologies of Fitch, Moody’s and S&P were examined in respect of the following processes:

- i) set up, monitoring and review of rating methodologies;
- ii) implementation of methodologies throughout the rating process;
- iii) internal mechanisms to ensure consistent application of rating methodologies; and
- iv) disclosure of methodologies.

These enquiries revealed shortcomings in the processes of disclosure and implementation of changes in bank rating methodologies, the rigorous and systematic application of methodologies and the review process of methodologies. The remedial action plans ESMA has put in place require the CRAs to:

- incorporate all relevant factors, models, assumptions and criteria in their methodologies;
- improve public disclosure of the methodologies;
- maintain adequate records with reference to analytical specifications of rating

instruments;

- develop proper procedures relating to changes in methodologies;
- improve the internal review process of performance of the methodologies; and
- ensure minimum standards of information quality and timeliness.

Progress on Systems and Controls

Following its 2012 Report identifying deficiencies in a number of CRAs' rating processes, governance and internal control mechanisms, ESMA has carried out further work to address these shortcomings. In response CRAs have put in place significant measures to:

- establish appropriate record-keeping and documentation processes;
- improve data quality and confidentiality;
- strengthen resources dedicated to internal control functions;
- increase transparency in the disclosure and presentation of ratings; and
- enhance the involvement of senior management in control activities.



Notes for editors

1. [Annual Report](#)
2. [2013 Credit Rating Agencies Supervision and Policy Work Plan](#).
3. ESMA is now [responsible](#) for the supervision of 19 registered and one certified CRA.
4. 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).
5. 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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