



European Securities and
Markets Authority

Report on staffing and resources

Report to the European Parliament, the Council and the Commission on ESMA's staffing and resource needs arising from the assumption of its powers and duties under the Regulation (EU) No 462/2013 amending Regulation (EC) No 1060/2009 on credit rating agencies

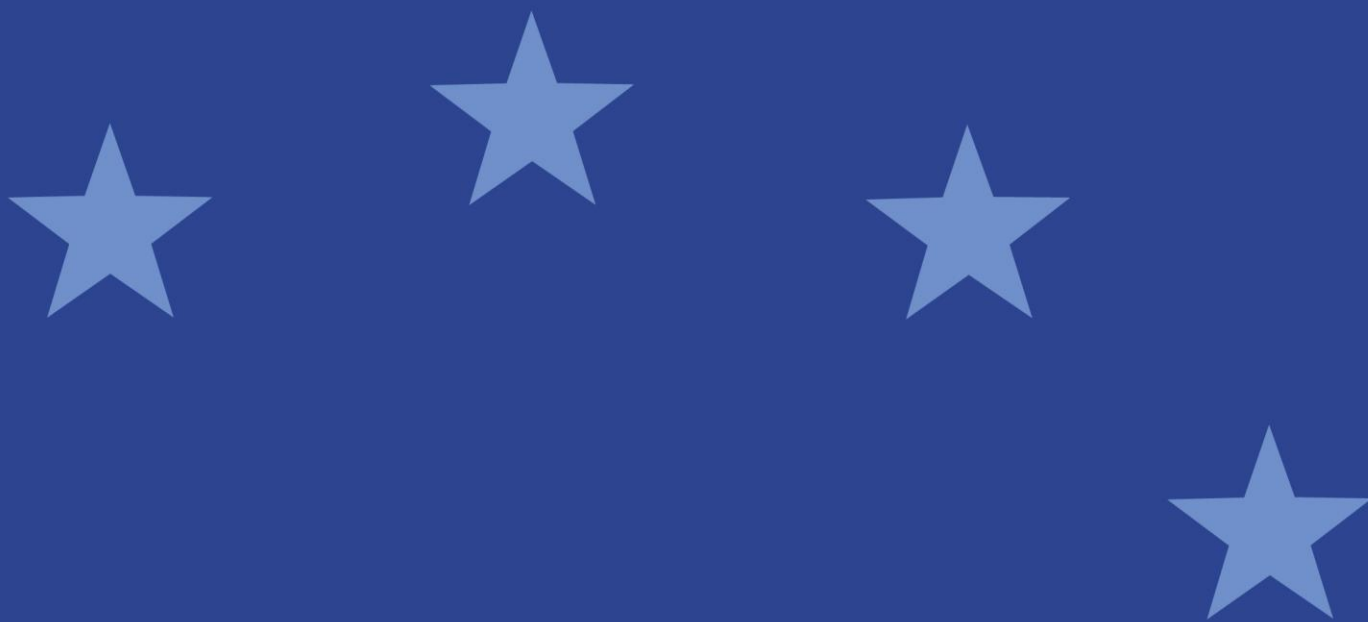




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Acronyms used

CEREP	Central Repository
CRA	Credit Rating Agency
CRA3	Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies
EBA	European Banking Authority
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
ESAs	European Supervisory Authorities
EU	European Union
IOSCO	International Organization of Securities Commissions
ITS	Implementing Technical Standards
NCA	National Competent Authority
RTS	Regulatory Technical Standards
SOCRAT	Supervision Of CRAs Tool

I. Executive Summary

Reasons for publication

Article 39a of Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies (the CRA Regulation) requires ESMA to assess the staffing and resources needs arising from the assumption of its powers and duties under the CRA Regulation and submit a report to the European Parliament, the Council and the Commission of these needs.

Contents

This paper describes the tasks that ESMA carries out in view of its responsibilities under the CRA Regulation. For each task the report analyses the implications in terms of processes and activities to be carried out. The report also provides the implications in terms of resources and budget. While ESMA experienced a steep increase of resources in the initial years following the entry into force of the CRA Regulation, incremental growth in staff numbers in 2015 and 2016 can be envisaged to adequately cope with additional tasks following from the CRA3 Regulation.



II. Introduction

1. Article 39a of Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies (the CRA Regulation) requires ESMA to assess the staffing and resources needs arising from the assumption of its powers and duties under the CRA Regulation and submit a report to the European Parliament, the Council, and the Commission of these needs.
2. The report provides an overview of all the tasks related to ESMA's responsibility in the field of CRA supervision and identifies the new tasks and responsibilities resulting from the CRA3 Regulation. On the basis of this overview of existing and new supervisory tasks, the report provides the implications in terms of resources and budget of ESMA.

III. ESMA's tasks in the field of CRA supervision

3. The CRA Regulation conferred all supervisory powers in the field of CRAs in the EU to ESMA. ESMA's tasks in the field of Credit Rating Agencies (CRAs) regulation and supervision can be grouped into the following main categories:
 - Perimeter assessment (i.e. identification of CRAs operating without registration);
 - Assessment of applications for registration/certification;
 - Day-to-day supervision;
 - Thematic and individual investigations;
 - Enforcement-related activity;
 - Cooperation with third-country regulators and international organisations;
 - Development of the single rule book via regulatory technical standards, technical advices, reports, endorsement decisions and equivalence technical advices,
 - Supervisory guidance - guidelines and Q&As;
 - Risk analytics – market intelligence, research and mapping

Perimeter / registration / certification

4. The CRA Regulation provides that a credit rating agency established in the EU must be registered in order to conduct credit rating activities and distribute credit ratings to the public in the Union for regulatory and non-regulatory purposes. The CRA Regulation does not apply to i) credit scores, ii) credit scoring systems or similar assessments; iii) private ratings; iv) credit ratings produced by export credit rating agencies; and v) under certain circumstance to credit ratings produced by central banks.
5. ESMA verifies whether there are companies conducting rating activities in the EU without registration. Such perimeter activity of ESMA has been part of a broader programme designed to improve guidance on the scope of the Regulation and to give clarity on ESMA's approach to perimeter activities, which resulted in the publication in December 2012 of the Guidelines and Recommendations on the scope of the Regulation¹.
6. At the time of the transfer of the exclusive supervisory powers to ESMA on 1 July 2011, there were five registered and one certified CRA. Since then, the number of registered and certified CRAs significantly increased with 23 registered CRAs (on a group basis) and two certified CRAs as at June 2014.
7. As regards assessment of application for registration/certification, ESMA assessed eleven applications: five CRAs were granted registration; one CRA was certified; two applications were

¹ [ESMA/2012/841 \(20 December 2012\) – Guidelines and recommendations on the scope of the CRA Regulation](#)

rejected and three applications were withdrawn during the process. ESMA is currently assessing various applications for registration. ESMA does not envisage any reduction in registration activity in the near future which will probably result in a higher number of registered CRAs.

Day-to-day supervision

8. The CRA Regulation requires that credit rating activities are conducted in accordance with the principles of integrity, transparency, responsibility and good governance in order to ensure that credit ratings are independent, objective and of adequate quality.
9. In light of these objectives, ESMA conducts day-to-day supervision with regard to various aspects of the CRA's rating process. For example, ESMA verifies whether the i) governance and internal control mechanisms; ii) management of conflicts of interests; iii) transparency and appropriate disclosure of ratings/methodologies; and iv) the use of methodologies which are rigorous, systemic, continuous and subject to validation, comply with the requirements in the CRA Regulation. ESMA's day-to-day supervisory activities can lead to supervisory findings which need to be addressed by the CRA concerned, including formal supervisory measures and sanctions.
10. As part of such on-going supervision, CRAs periodically submit to ESMA both quantitative (e.g. credit ratings data, credit ratings transitions, financial information) and qualitative (e.g. internal reviews on methodologies, updates to compliance work plans, identified conflicts of interest, board minutes, other relevant reports) information. ESMA uses this information to ensure a targeted and risk-based supervisory approach.
11. Furthermore, CRAs' notifications of material changes to their initial conditions for registration constitute an important source of information for ESMA's on-going supervisory activities. Such notifications of material changes regard for example: i) changes to members of the supervisory/administrative board; ii) new business activity; iii) issuance of new types of credit ratings; iv) organisational changes; v) changes in the structure of shareholders; vi) appointment of key positions such as heads of the compliance and review function; vii) changes to the outsourcing of important operational functions; and viii) use of endorsement. Likewise, complaints from third parties play an important role in the daily supervision of CRAs.
12. In addition, ESMA typically has interviews with each CRA's members of the supervisory board including independent directors, CEO and the persons responsible for the business development, compliance, review and risk management functions. These interviews allow ESMA to identify risks and support its day-to-day supervision activities.

Thematic and individual investigations

13. Individual or thematic investigations are used when ESMA identifies a risk of potential non-compliance for one or several CRAs. In those situations, dedicated attention and effort is expected to have the greatest impact on reducing the risk. Following targeted requests for information and on-site interviews, such investigations typically result in supervisory findings of ESMA in combination with a remedial action plan for the CRA. Ultimately, these investigations can also lead to formal supervisory measures and sanctions.

14. So far, ESMA conducted four thematic investigations. Following three thematic investigations, ESMA published the main findings and outcome². Moreover, ESMA conducted a thematic investigation into 14 small and medium-sized CRAs in accordance with the CRA Regulation's requirements (Article 40a(6)). ESMA also conducted two individual investigations in 2012 and 2013 respectively (i.e. investigation into governance and internal controls and rating dissemination processes). These investigations result in a significant amount of follow-up work on monitoring the implementation of remedial action plans by CRAs.
15. Planned investigations for 2014 include i) the on-going thematic investigation on the monitoring of structured finance ratings and ii) the thematic investigation on how some CRAs review and validate their methodologies, with a particular reference to the use of historical experience, including back-testing. Further, ESMA will complete the thematic investigation on small and medium-sized CRAs which were registered either at the end of 2012 or during 2013 and therefore not included within the scope of the 2013 investigation mentioned above. Finally, ESMA will conduct individual investigation on the rating review process and the IT systems and controls.

Enforcement

16. As part of its supervisory duties (day-to-day supervision and dedicated investigations), ESMA also assesses whether there are possible facts liable to constitute an infringement (as set out in the Regulation). Where this is the case, ESMA prepares a file for the appointed Independent Investigating Officer (IIO), who will investigate the matter (Article 23e of the Regulation). Such an appointment was made in two instances so far.
17. In June 2014, ESMA adopted its first supervisory measure in the form of a public notice³.

Cooperation with non-EU supervisors and international organisations

18. As part of its cooperation with non-EU supervisors of CRAs, ESMA exchanges supervisory information on a periodic basis with several non-EU supervisors (according to articles 5(7) and 34 of the Regulation). The cooperation with non-EU supervisors has been reinforced in 2013 with the establishment of supervisory colleges (with participating national supervisors of Australia, Brazil, Canada, Japan, Mexico and the US). The supervisory colleges aim to promote information-sharing and cooperation in order to enhance risk assessment of the three largest internationally active CRAs (i.e. S&Ps, Moody's and Fitch) and to support effective supervision of these CRAs. ESMA plays an active role in these colleges of supervisors of CRAs and, in particular, as the chair of the college for Fitch.
19. Furthermore, ESMA participates in IOSCO's Committee 6 which is responsible for several global policy work streams related to CRAs. For example, the Committee 6 is currently revising the IOSCO Code of Conduct for CRAs.
20. Finally, ESMA concluded Memoranda of Understanding with nine non-EU supervisors as part of its endorsement decisions of those jurisdictions. ESMA also provided technical advice to the European Commission for its equivalence assessment of those jurisdictions. In addition, ESMA concluded a Memorandum of Understanding with Dubai FSA.

² [ESMA/2012/207 \(22 March 2012\) – ESMA's report on the Supervision of Credit Rating Agencies](#). [ESMA/2013/308 \(18 March 2013\) – Credit Rating Agencies Annual Report 2012](#). [ESMA/2013/1775 \(2 December 2013\) – ESMA's Report on CRA sovereign ratings investigation](#)

³ [ESMA/2014/596 \(3 June 2014\) – ESMA censures Standard & Poor's for internal control failings](#)



Single rulebook

21. Following the adoption of the CRA2 Regulation, ESMA issued four draft RTS with regard to:
 - The information to be provided by a credit rating agency in its application for registration and the information that the credit rating agency must provide for the application for certification⁴;
 - The presentation of the information, including structure, format, method and period of reporting, that credit rating agencies shall make available in a central repository⁵;
 - The assessment of compliance of credit rating methodologies with the requirements of Article 8(3)⁶;
 - The content and format of ratings data periodic reporting to be requested from the credit rating agencies for the purpose of on-going supervision by ESMA⁷.
22. Furthermore, ESMA published Guidelines on the scope of the CRA Regulation, following a full consultation process. In addition, ESMA provided clarification through two sets of Q&A's on certain provisions of the CRA3 Regulation and ESMA published the registered CRAs' market share to enable issuers of structured finance instruments to identify and appoint a second CRA which does not have a market share in excess of 10%. Finally, ESMA provided technical support to the European Commission, European Parliament and Council during the CRA3 negotiations.
23. Finally, in accordance with Article 136 of the CRR Regulation, ESMA will contribute to the development of the required draft ITS on mapping by EBA and EIOPA. The consultation paper on the draft ITS on mapping has been adopted by the Joint Committee of the ESAs.

Risk analytics – Monitoring, research and mapping

24. CRA market intelligence and research (i.e. identification of trends and risks in the CRA industry), including analysis of information reported by CRAs in CEREP (semi-annual) and SOCRAT (monthly or bi-monthly) databases, are an important part of ESMA's supervisory activities. With the analysis of other information sources, ESMA keeps well informed about the most recent developments in the CRA industry. This contributes to the use of Key Risk Indicators (KRIs) which facilitate the identification of potential areas of non-compliance among the CRAs. The risk analysis also contributes to the development of an annual supervisory work programme and the implementation of new regulatory and supervisory tasks.
25. ESMA intends to further develop its engagement with external stakeholders. A stronger interaction with third parties having a stake in how the credit rating industry operates (e.g. issuers of financial instruments, rating users) will increase ESMA's understanding of the market's drivers and

⁴ [ESMA/2011/463 \(22 December 2011\) – Final report - Regulatory technical standards on the information for registration and certification of credit rating agencies](#)

⁵ [ESMA/2011/461 \(22 December 2011\) – Final report - Regulatory Technical Standards on the presentation of the information that credit rating agencies shall disclose in accordance with Article 11\(2\) and point 1 of Part II of Section E of Annex I to Regulation \(EC\) No 1060/2009](#)

⁶ [ESMA/2011/462 \(22 December 2011\) – Final Report - Draft RTS on the assessment of compliance of credit rating methodologies with CRA Regulation](#)

⁷ [ESMA/2011/464 \(22 December 2011\) – Final report - Draft RTS on the content and format of ratings data periodic reporting to be requested from credit ratings agencies for the purpose of on-going supervision by ESMA](#)



expectations, as well as identify and raise transparency on standards and good practice at industry level as a whole.

IV. ESMA's new tasks following the CRA3 Regulation

26. In addition to ESMA's activities mentioned above, the CRA3 Regulation resulted in additional supervisory tasks for ESMA in the following fields:
- Sovereign ratings (i.e. including additional transparency requirements, calendar for publishing of rating changes and minimal frequency of yearly reviews);
 - Structured finance ratings (i.e. including maximum duration of the contractual relationship with a CRA);
 - Fees charged by CRAs to their clients;
 - Daily reporting by CRAs to the new European Rating Platform (ERP) and analysis of the reported data;
 - Conflicts of interest concerning shareholding (or a company with a dominant influence) in CRAs;
 - Additional disclosure and notification requirements with regards to errors or material change to rating methodologies and their application.
27. In addition, ESMA will be required to set up the necessary arrangements to implement the RTS on the ERP and the RTS on fees charged by CRAs to their clients. This might include establishing reporting instructions for the ERP and on-going monitoring of the daily reported data once the ERP is fully operational. Likewise, the RTS on fees requires some kind of IT platform to allow for the supervision of fees charged by CRAs to their clients.
28. CRA3 also requires ESMA to submit a report to the European Commission on the possibility of establishing one or more mappings of credit ratings submitted by CRAs on the ERP.
29. Another major work stream resulting from the CRA3 Regulation is the delivery of Guidelines on Reducing Reliance on Ratings. These are to be produced in cooperation with the other ESAs to reduce financial intermediaries' dependence on external ratings for creditworthiness assessments. Work has already been completed on the deletion of mechanistic references to credit ratings in ESMA's guidelines and recommendations.
30. Following the CRA3 Regulation, ESMA will now be required to provide on an annual basis the market shares of the registered CRAs.
31. Furthermore, CRA3 requires ESMA to provide technical advice to the European Commission on the following topics:
- Technical advice on the feasibility of a network of small and medium sized CRA;
 - Technical advice providing a view to deleting all references to credit ratings in Union law for regulatory purposes;
 - Technical advice on the situation in the credit rating market for structured finance instruments, assessing in particular:

- i. the availability of sufficient choice in order to comply with the requirements set out in Articles 6b and 8c;
 - ii. whether it is appropriate to shorten or extend the maximum duration of the contractual relationship referred to in Article 6b(1) and the minimum period before the credit rating agency may re-enter into a contract with an issuer or a related third party for the issuing of credit ratings on re-securitisations referred to in Article 6b(3);
 - iii. whether it is appropriate to amend the exemption referred to in the second subparagraph of Article 6b(2).
- Technical advice on whether there is a need to extend the scope of the obligations referred to in Article 8b to include any other financial credit products;
 - Technical advice on whether the requirements referred to in Articles 6, 6a, and 7 have sufficiently mitigated conflicts of interest;
 - Technical advice on whether the scope of the rotation mechanism referred to in Article 6b should be extended to other asset classes and whether it is appropriate to use differentiated lengths of periods across asset classes;
 - Technical advice on the appropriateness of existing and alternative remuneration models;
 - Technical advice on whether there is a need to implement other measures to foster competition in the credit rating market;
 - Technical advice on the appropriateness of additional initiatives to promote competition in the credit rating market against the background of the evolution of the structure of the sector;
 - Technical advice on whether there is a need to propose measures to address contractual over-reliance on credit ratings;
 - Technical advice the market concentration levels, the risks arising from high concentration and the impact on the overall stability of the financial sector.
32. Finally, following the finalisation of the RTS on structured finance instruments, ESMA is also responsible for the establishment of the related IT platform. ESMA will also continue to develop additional standardised disclosure templates.

V. Total resources needed for CRA Regulation

33. While ESMA experienced a steep increase of resources in the initial years following the entry into force of the CRA Regulation, ESMA now deems an incremental growth necessary to accomplish its regulatory duties as previously described for each area of activity.
34. Following the entry into force of CRA3, there will be additional CRA supervisory tasks (e.g. additional requirements for sovereign and structured finance ratings; supervisory work on fees charged by CRAs; conflicts of interest). Further work also ensues from the additional requirements of CRA3 in relation to the reduction on reliance of ratings.
35. The implementation of the RTS related to IT will require additional work, for instance with regard to the analysis of data submitted on a daily basis on the ERP. It is also expected that CRA3 implementation will still require resources after the RTS are finalised to provide on-going guidance to the market. Following the completion of the RTS, ESMA envisages further work on the implementation of the platform for structured finance instruments as mentioned above.
36. In addition, ESMA needs to further develop its analysis of the CRA industry, market intelligence, and increase its level of engagement with external stakeholders such as issuers and users of ratings.
37. At the same time, it is reasonable to expect an increasing number of registered and certified CRAs in the coming years. The likely increase in the number of registered and certified CRAs in 2015 and 2016 ensues from the applications currently being assessed as well as the continued interest from a number of firms in anticipation of future applications for registration. The growth in number of registered CRAs will naturally result in additional supervisory activities for ESMA.
38. Therefore an incremental growth in staff numbers between 2014 and 2016⁸ would allow to adequately cope with the above additional tasks.
39. ESMA envisages that the cost of the additional posts required to fulfil the above activities would be covered by fees levied on the industry (more details in next section). The work related to the implementation of the platform for structured finance instruments will not be funded by the fees charged to CRAs.
40. Based on the previously described tasks and responsibilities, the following table provides ESMA's staffing plans in the field of CRAs' regulation and supervision. These plans feed into ESMA's establishment plan annually submitted to the European Institutions.

⁸ Planned budgetary and staffing figures presented here for 2015 are consistent with ESMA's budget request, as submitted to the European Institutions by its Board of Supervisors. The figures for 2016 are an initial estimation.

Table 1

	CRA Unit staff– basis for ESMA’s establishment plan (FTE*)	Registered (certified) groups of CRAs
2012	15	19(1)
2013	32	22(2)
2014	33	23(2)**
2015	34	-
2016	35	-

* The FTE number includes temporary agents (TAs), contract agents (CAs) and seconded national experts (SNEs)

** Number of registered (certified) groups of CRAs at the end of June 2014

41. In 2013, around 35% of staff time was engaged in thematic and individual investigations, 20% in day-to-day supervision (including enforcement), 25% in single rulebook and international cooperation, and 10% in both registration/perimeter and risk-analysis related activities.
42. It has to be noted that ESMA is not currently accounting for potential additional supervisory activities ensuing from major disruptive events in the financial markets or further material legislative changes which would require ad-hoc supervisory intervention in the field of credit rating agencies.
43. Other authorities with credit rating agency regulatory responsibilities, such as the SEC’s Office of Credit Ratings in the US, have teams of a size comparable to that of ESMA.

VI. Fees charged to credit rating agencies to cover ESMA's activity

44. ESMA's activity on credit rating agencies is covered by the annual fees paid by the supervised CRAs. CRAs started paying fees to ESMA in 2012, the first full year after ESMA's inception.
45. The fees contribution amount to be paid by the supervised entities is part of ESMA's budget. ESMA has to submit its request for funds to the European Institutions almost a year in advance of the relevant budget year. Consequently, the amount of ESMA's budget funded by fees paid by the supervised entities is based on ex-ante assumptions rather than on actual costs which are only available ex-post.
46. The following table provides the evolution of the fees paid (until 2014) or projected to be paid (after 2014) by CRAs, which are based on the staffing needs included in Table 1. As previously explained, work related to the implementation of the platform for structured finance instrument will not be funded by the fees charged to CRAs.

Table 2

	2012	2013	2014	2015	2016
CRAs' fees (euro/000)	3,001	5,664	5,539	7,603	8,048

47. While the year-on-year amount of CRAs' fee contributions is mainly driven by the development of the staff expenditure (accounting for around 60% of the total fees), other factors are also taken into consideration such as CRA-related IT projects (e.g. establishment and maintenance of CRA databases, such as CEREP, SOCRAT and, going forward, ERP), missions, on-site investigations etc. Furthermore the fees calculation has been refined over the years, with the following two main changes impacting the 2015 and 2016 calculation:
- **2015:** starting in 2015, the fees calculation includes overhead expenditure, namely 15% for administrative staff (resulting in additional Euro 0.7 million compared to 2014) and a further 15% overall for legal advice and IT staff working on the CRA-related IT projects (resulting in additional Euro 0.7 million compared to 2014). The budgeted IT projects' costs also reach a peak in 2015 due to the CRA3 implementation (resulting in additional Euro 0.4 million compared to 2014);
 - **2016:** as a result of the amendments to the staff regulation of officials of the European Union⁹, starting 1 January 2016 there is an additional employer's contributions to the EU pension scheme corresponding to the proportion of ESMA's revenues received from CRAs' fees.

⁹ Art. 83a(2) of Regulation No 1023/2013 of the European Parliament and of the Council of 22 October 2013 amending the Staff Regulations of Officials of the European Union



VII. Funding of ESMA's activities in the field of CRAs

48. The funding system of ESMA is based on three revenue sources: i) contribution from NCAs; ii) subsidy from the EU; iii) collection of fees from supervised entities (CRAs and Trade Repositories). After subtracting the collected fees from the total budget of ESMA, the remainder of the budget is funded 40% by the EU and 60% by NCA contributions. According to current projections for 2015, collected fees will cover 25% of ESMA's budget, the balance being covered in line with the 40%-60% split by the EU and the NCAs (which results in the EU funding 30%, and the NCAs 45%, of ESMA's budget for 2015).
49. ESMA currently presents one budget request every year to fund its activities, without distinction between the activities which are funded by the fees paid by the supervised entities and the activities which need to rely on NCA and EU contributions.
50. In future budget requests, ESMA would like to be able to clearly show the resources that are planned for fee-funded activities. ESMA's budget would remain as one line in the EU budget but in an annex we would show the part of the establishment plan and budget related to our fee-funded activities. This would provide the European Institutions with enough clarity to ensure that they do not inadvertently impact ESMA's supervisory capacity by limiting ESMA's budget and establishment plan as a whole. ESMA hereby requests endorsement from the European Parliament, the Council and the Commission for this course of action.