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PRESS RELEASE

ESMA sees progress in reform of EU credit rating industry

The European Securities and Markets Authority (ESMA) has published two sets of Technical Advice and a Report on the regulation of credit rating agencies (CRAs) in the EU. These papers provide an overview of competition and give insight into the market dynamics of this industry. They also consider measures to provide stronger controls around credit ratings for structured finance instruments and to reduce reliance on credit ratings.

The Report finds that the EU CRA Regulation has improved the governance and operation of CRAs but that it is too soon to comprehensively assess the impact of measures regarding competition and conflicts of interest included in the CRA Regulation of 2013. ESMA's key findings at this stage are:

- The dynamics of the CRA industry are more complex than initially foreseen as most of the 24 CRAs now registered in the EU focus on a particular asset class or Member State. Only the largest CRAs offer credit ratings for all different asset classes throughout the EU and globally;
- The high fees charged and regular fee increases imposed by some CRAs suggest there may be little effective competition for the provision of credit ratings in some specific market segments within the EU at present;
- Following the financial crisis, the CRA Regulation aimed to improve investor confidence and stimulate competition for the provision of structured finance ratings, but ESMA finds that the measures adopted have had little impact to date. The provisions relating to the mandatory rotation of CRAs rating certain re-securitisations have not yet been used in practice as the re-securitisation market has not recovered since the financial crisis. Equally, measures requiring multiple credit ratings for structured finance instruments have had little impact as they represent existing market practice; and
- Regarding reducing reliance on ratings, references to credit ratings still remain in national and EU legislation, as well as within the collateral frameworks of some central banks. As it may not be practical to remove all of these references, ESMA notes future action should focus on mitigating mechanistic reliance on credit ratings rather than removing

them from legislation entirely.

Steven Maijoor, ESMA Chair, said:

> “The financial crisis made it clear that reforming the CRA industry was imperative in order to have safer financial markets and I am pleased to report that the resulting legislation and our role as direct supervisor of CRAs are having a positive impact.
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> “While it is encouraging to see that changes are taking place, we are realistic and know there is still work to be done which is why we have made recommendations relating to further supervisory powers regarding the appointment of independent non-executive directors and enhanced enforcement powers.”

In particular, ESMA makes two recommendations:

- It would benefit from further supervisory powers regarding the appointment of independent non-executive directors by CRAs; and
- Its enforcement powers would be more effective if all requirements of the CRA Regulation had a corresponding infringement and if fines could better reflect a CRA’s turnover to ensure they have a proportionate and deterrent effect on CRAs of different sizes.

Next steps

The European Commission will consider ESMA’s Technical Advice and Report and then issue its own reports to the European Parliament and Council on whether all references to credit ratings should be removed from EU law for regulatory purposes and on the implementation of provisions of the CRA Regulation relating to competition, conflicts of interest and structured finance products. ESMA proposes to reassess the implementation of the CRA Regulation within the next 3 to 5 years.

Notes for editors

1. ESMA is an independent EU Authority established in 2010. It forms part of the European Supervisory Authorities, which also include the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Systemic Risk Board (ESRB).

2. ESMA contributes to the regulation of financial services firms with a pan-European reach, both through direct supervision and through the active co-ordination of national supervisory activity. ESMA's mission is to enhance the protection of investors and promote stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU.

3. Regulation 1060/2009 on credit rating agencies entered into force on 7 December 2009. The CRA Regulation has already been extended twice: by Regulation 513/2011 which entered into force on 1 June 2011 and by Regulation 462/2013 which entered into force on 20 June 2013. (The CRA Regulation)

4. The CRA Regulation was one of the EU's first regulatory responses to the 2008 financial crisis. It requires companies to be registered as credit rating agencies (CRAs) before they can issue credit ratings in the EU. In order to be registered, a company must be able to demonstrate that it complies with the requirements of the CRA Regulation, for example as regards the methodologies used to develop credit ratings and the governance and internal control structures in place. In this way the regulation of credit rating agencies in the EU seeks to ensure that credit ratings issued respect minimum standards of quality and independence.

5. The 2011 amendments to the CRA Regulation gave ESMA the power to register and directly supervise CRAs as well as the power to take enforcement action against them for failure to meet the standards set out in the CRA Regulation. The 2013 amendments to the CRA Regulation contained a number of further provisions including measures to help reduce reliance on credit ratings and stimulate competition between credit rating agencies operating in the EU.

6. Article 11a of Regulation 462/2013 requires ESMA to establish The European Rating Platform (ERP). The ERP will publish all ratings issued by registered CRAs operating under the issuer-pays model of issuing ratings. It will allow users to access information to compare credit ratings issued by different CRAs.

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