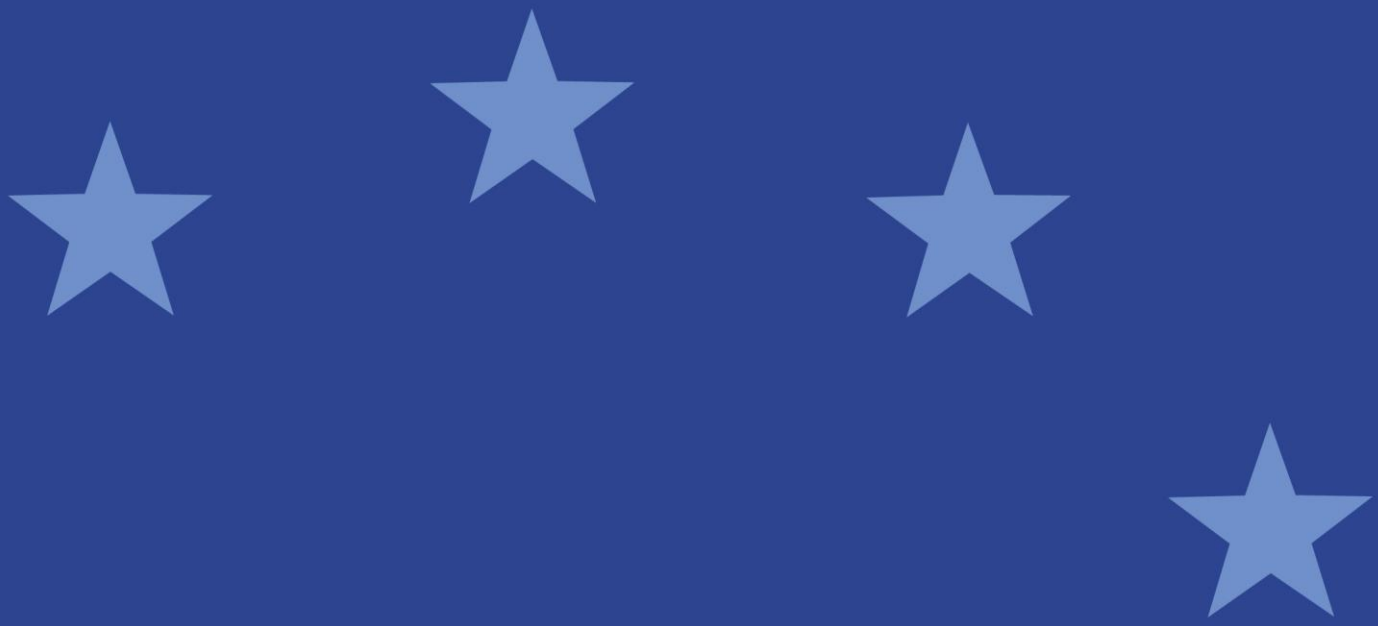
esma European Securities and Markets Authority

Final Report

Technical advice on CRA regulatory equivalence – CRA 3 update



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1 Executive Summary

1. In carrying out its functions under the CRA Regulation, ESMA is responsible for ensuring that credit ratings issued in the European Union are of a high quality and contribute to investor protection and the smooth functioning of the internal market.

2. As set out in Article 2 of the CRA 3 Regulation a number of requirements introduced by the CRA 3 Regulation will apply for the purposes of the equivalence regime under Article 5(6) from 1 June 2018.

3. In this regard, on 13 July 2017, ESMA received a letter from the European Commission requesting a new technical advice on the equivalence of certain third-country legal and supervisory frameworks with these additional equivalence requirements introduced by CRA 3.

4. In line with this request for Technical Advice, ESMA has re-assessed those third country legal and supervisory frameworks (Argentina, Brazil, Mexico, United States, Canada, Hong Kong, Singapore, Japan and Australia) that had previously been deemed as meeting the objectives of the EU regime for the regulation of CRAs.

5. These third country legal and supervisory frameworks had previously been assessed against the full requirements of the CRA 1 and CRA 2 Regulations in separate Technical Advices issued in 2010, 2012 and 2013.

6. In order to provide a clear structure to this assessment, ESMA has grouped the new CRA 3 requirements according to different high level areas of the Regulation. These groupings are consistent with each area of previous technical advices as well as ESMA's methodological framework for assessing equivalence in order to assist cross comparison.

7. The approach is to assess the legal and supervisory framework in respect of each grouping, providing a concluding assessment for each area. Following this, each country is given a general conclusion as to whether it's legal and supervisory framework is meeting the objectives of the additional equivalence requirements of CRA 3 Regulation.

8. As a result, for this Technical Advice, ESMA's assessment has focused exclusively on the new CRA 3 requirements. The approach taken has been to assess the capability of the regime in the third country to meet the objectives of the new CRA 3 requirements. Therefore this Technical Advice should be read in conjunction with the earlier Technical Advices, as well as the methodological framework included in in Annex III.

9. Following the completion of the technical equivalence assessments, the third-country legal and supervisory frameworks that have been deemed as meeting the objectives of the additional CRA 3 requirements for the purposes of equivalence are Canada, Hong Kong, Mexico, Japan and the United States. It is noted that the assessment for Canada is contingent on a proposed rule change being adopted and implemented into law before 1 June 2018.

2 Definitions

CESR	Committee of European Securities Regulators
ESMA	European Securities and Markets Authority
EC	The European Commission
CRA	Credit rating agency
CRAR	The CRA Regulation: Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit ratings agencies as amended by Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011, Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011, Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013, and Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014
CRA 1	Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit ratings agencies
CRA 2	Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011
CRA 3	Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013
The 2010 technical advice	Technical Advice to the European Commission on the Equivalence between the Japanese Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies" (CESR/10-33) adopted in June 2010
MF	Methodological Framework

3 Introduction

1. Article 5(6) of the CRA Regulation empowers the European Commission (EC) to adopt an equivalence decision, stating that the legal and supervisory framework of a third country ensures that CRAs authorised or registered in that third country comply with legally binding requirements which are equivalent to the requirements resulting from the CRA Regulation and are subject to effective supervision and enforcement in that third country.

2. In a letter to ESMA's legal predecessor, the Committee of European Securities Regulators (CESR), the Commission committed to a procedure, whereby ESMA provides its third-country equivalence assessment in a technical advice before the Commission takes a decision on equivalence[1]. On the basis of a request for technical advice from the Commission, CESR, and later ESMA, has published its technical advice on the following nine third-country jurisdictions:

    - 2009: Japan[2]
    - 2010: United States[3]
    - 2012: Canada, Australia and update of assessment of United States[4]
    - 2013: Mexico, Argentina, Brazil, Hong Kong and Singapore[5].

3. These Technical Advices assessed the legal and supervisory frameworks of these third country jurisdictions against the full requirements of the CRA 1 and CRA 2 Regulations, which included an assessment of the effectiveness of the supervision.

4. On 13 July 2017, ESMA received a letter (Annex I) from the EC with a request for technical advice on the equivalence of certain third-country legal and supervisory frameworks with the additional requirements for equivalence introduced by EU

[1] Brussels, 12 June 2009 | MARKT/G3/MTF/mg Ares (2009). Letter addressed to Mr Eddy Wymeersch Chairman Committee of European Securities Regulators (CESR). Subject: Request for CESR technical advice on the equivalence between certain third country legal and supervisory frameworks and the EU Regulatory Regime for credit rating agencies. See section 1.2 of the attached mandate "Mechanism for assessing the equivalence". The relevant section of the letter can be found on page 228 of CESR's "Technical Advice to the Commission on the Equivalence between the Japanese Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies" Date: 9th June 2010, Ref.: CESR/10- 333 available at https://www.esma.europa.eu/sites/default/files/library/2015/11/10_333.pdf.

[2] CESR/10- 333: Technical Advice to the Commission on the Equivalence between the Japanese Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies, available at https://www.esma.europa.eu/sites/default/files/library/2015/11/10_333.pdf.

[3] CESR/10-332: Technical Advice to the European Commission on the Equivalence between the US Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies, available at: https://www.esma.europa.eu/system/files_force/library/2015/11/10_332.pdf

[4] ESMA/2012/259: Final report Technical advice on CRA regulatory equivalence - US, Canada and Australia, , available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2012_-259_0.pdf

[5] ESMA/2013/626, Final report Technical advice on CRA regulatory equivalence – on Argentina, Brazil, Mexico, Hong Kong and Singapore, available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-626_esma_technical_advice_on_equivalence_of_argentina_brazil_mexico_hong_kong_singapore_with_eu_on_cras_supervision_30_may_2013.pdf

Regulation 462/2013 of 21 May 2013 amending Regulation 1060/2009 on credit rating agencies (hereinafter "CRA 3"). These new requirements enter into force for the purpose of equivalence 1 June 2018[6].

4 Purpose and use of the European Commission's equivalence decision

5. Equivalence/certification is one of two regimes provided for in the CRA Regulation which allow credit ratings issued in a third country to be used for regulatory purposes in the EU; the other being endorsement.

6. The **equivalence regime** is only available for third-country CRAs which are certified by ESMA and which have no presence or affiliation in the EU provided the activities of the third-country CRA and/or their credit ratings are not of systemic importance for the financial stability or integrity of the financial markets of one or more EU Member States. It is important to highlight that credit ratings issued by the third-country CRA related to an EU entity or instrument cannot be used for regulatory purposes in the EU.

7. A decision by the EC in accordance with Article 5(6) of the CRA Regulation recognising the legal and supervisory framework of a third country as equivalent to the requirements of the CRA Regulation is a necessary but insufficient condition for certification. Subsequent to an equivalence decision, a CRA in the assessed jurisdiction can apply for certification with ESMA provided that the following conditions set out in Article 5(1) of CRAR are met:

    a. the CRA is authorised or registered in and is subject to supervision in that third country;

    b. the cooperation arrangements referred to in Article 5(7) of the CRA Regulation are operational;

    c. the credit ratings issued by the credit rating agency and its credit rating activities are not of systemic importance to the financial stability or integrity of the financial markets of one or more Member States.

8. As of the date of this report, four CRAs are certified by ESMA[7]:

    - Japan Credit Rating Agency Ltd – established in Japan
    - Kroll Bond Rating Agency – established in the United States

[6] C.f. Article 2 of CRA III.
[7] The list of registered and certified CRAs is available on ESMA's website: https://www.esma.europa.eu/supervision/credit-rating-agencies/risk

- HR Ratings de México, S.A. de C.V. (HR Ratings) – established in Mexico
- Egan-Jones Ratings Co. (EJR) – established in the United States

9. The other regime which allows for credit ratings elaborated outside the Union to be used for regulatory purposes is 'endorsement'. The **endorsement regime** is available for third-country CRAs which are affiliated with or members of the same group as an EU CRA. An important difference is that the scope of the endorsement regime is broader: a credit rating may under certain circumstances be endorsed even when it relates to an EU entity or instrument and/or is of systemic importance to the financial stability or integrity of the financial markets of one or more EU Member States.

10. An assessment of the third-country legal and supervisory framework is also a precondition for endorsement. Whereas the technical assessment of equivalence is based on the methodological framework (MF) provided in Annex III to this report, a different MF is used for assessing the conditions for endorsement. The MF for assessing a third-country legal and supervisory framework for the purpose of endorsement (the endorsement MF) is provided in Annex II to the Final Report of the 2017 Guidelines on Endorsement[8]. The endorsement MF consists of a subset of the requirements provided in the MF for equivalence[9]. The endorsement MF focuses on the same seven areas as the MF for equivalence[10], but for each area, ESMA has identified the minimum requirements which should be reflected in the legislation of the third-country in order to meet the conditions for endorsement.

11. The distinction between the MFs for endorsement and equivalence should be also seen in the broader context of the two regimes which differ, inter alia, in terms of objective, scope and ESMA's supervisory involvement.

12. The MF for equivalence is prescriptive and rigorous. This is important as ESMA has limited powers to monitor credit ratings entering the Union under this regime and, therefore, has to rely almost exclusively on the supervisory activities of the third-country supervisor.

13. The endorsement MF consists of a subset of the criteria considered in the equivalence MF. However, unlike the equivalence regime, the endorsement regime contains safeguards beyond the legal and supervisory framework of the third country to ensure the quality of the rating activities. First, in addition to complying with the rules and regulations of the third-country, the third-country CRA should adhere to its own policies and procedures which should be at least as stringent as the relevant provisions of

[8] Final Report on the Update of the Guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation (ESMA 33-9-205).
[9] See Guidelines on the application of the endorsement regime under Article 4(3) of the CRA Regulation (ESMA/2011/139) adopted in May 2011.
[10] Scope of the regulatory and supervisory framework, corporate governance, conflicts of interest management, organisational requirements including confidentiality and record keeping, quality of methodologies and quality of ratings, disclosure and supervision and enforcement.

CRAR[11]. Second, endorsement requires that an EU CRA assumes full responsibility for ensuring that an endorsed credit meets these additional requirements. Third, ESMA has the power to monitor and assess, through the endorsing CRA, the conduct by the third-country CRA resulting in the issuing of an endorsed credit rating. Fourth, ESMA can take supervisory measures against an endorsing CRA which fails to ensure that an endorsed credit rating meets the standards of CRAR.

14. It is important to highlight that the technical assessments for equivalence as well as the final determination of the equivalence by the EC do not interfere with the technical assessments for endorsement or the endorsement regime. In this regard, ESMA has assessed all the jurisdictions previously accepted for endorsement against both MFs. The conclusion of these assessments was that all the previously assessed jurisdictions meet the conditions for endorsement. However, as explained in this Technical Assessment, it is ESMA's advice to the Commission that only some jurisdictions can be considered to have legally binding rules which are equivalent to the CRA 3 requirements.

[11] The requirements set out in Articles 6-12 and Annex I with the exception of Articles 6a, 6b, 8a, 8b, 8c, 8d and 11a, point (ba) of point 3 and points 3a and 3b of Section B as well as part III of Section D of Annex I of CRAR.

5 ESMA approach to assessing the new requirements introduced by CRA 3 with relevance to equivalence

15. In the EC letter of July 2017 requesting technical advice on the equivalence of certain third-country legal and supervisory frameworks with the additional requirements for equivalence introduced by the CRA 3, the EC provided instructions for the "Working approach for the Technical Advice" (see Annex I). Specifically, the EC asked ESMA for providing a technical assessment focusing on the differences between the substantive provisions of the additional requirements for equivalence and the third-country legal framework in question including a judgment on the material importance of those differences from a technical perspective without political implications[12].

16. A list of all the legal changes introduced by CRA 3 with relevance for equivalence (i.e. falling within the scope of Article 5(6)(b) of the CRA Regulation) is provided in Annex II to this document. Annex III contains the consolidated MF for assessing equivalence taking into account these new CRA 3 requirements. The MF in Annex III is based on the MF published in the 2017 Consultation Paper proposing an to update ESMA's guidelines on Endorsement[13] and updated taking into account the criteria provided in the "Working approach for the Technical Advice" of the July 2017 letter from the Commission[14].

17. The current technical equivalence assessments only focuses on the capability of the regime in the third country to meet the objectives of the additional CRA 3 regulatory requirements and provides a conclusion in this regard. The approach taken has been to assess whether the third-country legal and supervisory frameworks can achieve the overall objectives of the EU requirements. In doing so the focus of the assessments has been on the differences between the substantive provisions of the additional CRA 3 requirements and the third country's legal and supervisory framework.

18. In performing the desk-top technical assessments, ESMA circulated a questionnaire to those third-country jurisdictions which were deemed equivalent by the EC asking to indicate their national legal provisions corresponding to the new CRA 3 requirements. The jurisdictions were, furthermore, requested to submit an English translation of the relevant legal instruments governing the supervision of CRAs. The technical assessments have been developed on the basis of this information as well as follow-up discussions with representatives of the third-country regulators in order to obtain a better understanding of the third-country legal and supervisory framework.

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[12] See Annex I.

[13] Consultation Paper Update of the guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation4 April 2017 | ESMA33-9-159. Available at: https://www.esma.europa.eu/sites/default/files/library/esma33-9-159_consultation_paper_update_of_the_guidelines_on_the_application_of_the_endorsement_regime_under_article_43_of_the_credit_rating_agencies_regulation.pdf

[14] Ibid.

19. The technical assessments provided in this report follow the same structure as the previous assessments provided to the EC focusing on the five key areas which were amended by the additional requirements for equivalence of CRA 3:

    a. Scope of the regulatory and supervisory framework (Rating Outlooks)

    b. Conflicts of interest management

    c. Organisational requirements (confidentiality)

    d. Quality of methodologies and of credit ratings

        i. Quality of credit ratings and analysis of information used in assigning credit ratings

        ii. Quality of methodologies and changes to them

    e. Disclosure

        i. Presentation and disclosure of credit ratings

        ii. Periodic disclosure about the CRA and competition

20. Consequently, the technical advice provided in this report focuses exclusively on the CRA 3 requirements without reassessing requirements, which were already assessed in the previous advice. This technical advice, therefore, needs to be read in conjunction with the previous technical advices provided to the Commission. This provides a global overview on the third-country legal and supervisory frameworks.

21. This document constitutes a technical advice to the EC. However, the final determination is concluded by the EC and published in the Official Journal.

22. For those third countries assessed as not meeting the objectives of the CRA 3 regulatory requirements, ESMA invites the EC to explore whether there is willingness among the relevant authorities to move closer towards CRA 3 requirements. If this is the case, and the third-country authority formally commits to align with the EU standards, ESMA considers it would be appropriate for the EC to grant a transitional period in order to provide safeguards on continuity in EU and third-country markets.

23. The requirements contained in the new CRA 3 provisions with relevance to equivalence fall under the following headings and are summarised below:

5.1 Scope of the regulatory ad supervisory framework (rating outlooks)

24. Nearly all requirements applicable to credit ratings were extended by CRA 3 to cover rating outlooks as well. The background for this requirement is set out in recital 7 of CRA 3: "*The relevance of rating outlooks for investors and issuers and their effects on markets are comparable to the relevance and effects of credit ratings. Therefore, all the requirements of Regulation (EC) No 1060/2009 which aim at ensuring that rating actions are accurate, transparent and free from conflicts of interest should also apply to rating outlooks. According to current supervisory practice, a number of requirements of that Regulation apply to rating outlooks. This Regulation should clarify the rules and provide legal certainty by introducing a definition of rating outlooks and clarifying which specific provisions apply to such rating outlooks. The definition of rating outlooks should also encompass opinions regarding the likely direction of a credit rating in the short term, commonly referred to as credit watches.*"

25. In the MF, ESMA recognised that some jurisdictions may be covering rating outlooks in their supervisory practice without providing a definition of outlooks in their legislation. Consequently, ESMA explains in its MF that while the CRA Regulation provides a definition of a rating outlook in Article 3(1)(w), ESMA may accept that no such explicit definition is provided in a third-country legal framework.

5.2 Conflicts of interest management

26. CRA 3 introduced a general rule in Article 6(4) to ensure that CRAs establish, maintain, enforce and document an effective internal control structure governing the implementation of policies and procedures to prevent and mitigate possible conflicts of interest and to ensure independence. Furthermore, rules to identify, disclose and manage or eliminate actual and potential conflicts of interests were extended to explicitly cover significant shareholders. In particular, specific thresholds of cross-ownership were introduced:

    a. A CRA should not issue a credit rating when a shareholder or member of a CRA holding 10 % or more of either the capital or the voting rights of that CRA or being otherwise in a position to exercise significant influence on the business activities of the CRA, holds 10 % or more of either the capital or the voting rights of the rated entity or of a related third party, or of any other ownership interest in that rated entity or third party.

    b. A CRA or any person holding, directly or indirectly, at least 5 % of either the capital or voting rights of the credit rating agency or being otherwise in a position to exercise significant influence on the business activities of the credit rating agency shall not provide consultancy or advisory services to the rated entity or a related third party.

27. The background for these provisions is described in Recital 20 of CRA 3. As CRA 1 only addressed conflicts of interest caused by rating analysts, persons approving the credit ratings or other employees of the CRA, CRA 3 extended the scope to include conflicts of interests caused by shareholders or members holding a significant position within the CRA.

28. In its MF, ESMA included a requirement that third-country laws and regulations should provide sufficient protection against the risk that the interests of a significant shareholder affect the independence of the CRA, its analysts and/or its credit ratings/rating outlooks. Nevertheless, ESMA accepts that thresholds in a third country may be different or that the third-country legislation does not explicitly address shareholders requirements.

5.3 Organisational requirements (Confidentiality)

29. The CRA 3 provisions relating to confidentiality are precise and prescriptive. Article 10(2)a of the CRA Regulation requires CRAs to treat all credit ratings, rating outlooks and information related thereto as inside information up until the point of disclosure. In addition, Article 10(2)a requires that Article 6(3) of the Market Abuse Directive[15] applies to credit rating agencies as regards their duty of confidentiality and their obligation to maintain a list of persons who have access to their credit ratings, rating outlooks or related information, before disclosure.

30. As stated in paragraph 90 of the MF, ESMA considers this requirement to be important, and it expects the objectives of these requirements to be met for the purposes of assessing equivalence.

5.4 Quality of methodologies and credit ratings (analysis of the information used in assigning credit ratings)

31. In CRA 3, further clarification is provided regarding the requirement to inform a rated entity of its credit rating ahead of publication. The background for this requirement is provided in recital 41 of CRA 3: "*The current rules provide for credit ratings to be announced to the rated entity 12 hours before their publication. In order to avoid such notification taking place outside working hours and to leave the rated entity sufficient time to verify the correctness of data underlying the credit rating, the rated entity should be notified a full working day before publication of the credit rating or of a rating outlook* […]"

32. ESMA maintains the approach to this requirement which was taken in its previous technical advice on equivalence: ESMA does not consider it necessary that there is a specific requirement that the CRA inform the rated entity at least a full working day before the publication of a credit rating. Other timeframes may be acceptable as long as the

[15] Now Articles 17(8) and 18(1) of the Market Abuse Regulation.

CRA provides to the rated entity with the opportunity to draw attention to possible factual errors.

5.5 Quality of methodologies (changes to rating methodologies)

33. The new CRA 3 rules require CRAs to carry out public consultations when modifying their methodologies and publish the responses to the consultation. They also explicitly require the issuance of a credit rating to be carried out in accordance with a published methodology. Finally, errors in methodologies should be reported directly to ESMA, as a supervisor, and affected rated entities and should be corrected promptly.

34. The background for these new requirements is provided in recital 27 to CRA 3, which stresses the importance of avoiding that modifications of rating methodologies result in less rigorous methodologies. This requirement was also intended to help rating users understand the reasons behind new methodologies.

35. ESMA considers that these requirements are significant in ensuring that the CRA is able to achieve a high level of transparency and quality of rating methodologies. However, ESMA does not expect identical requirements to be hard-wired into a third-country regulatory framework if the third-country supervisory and legal framework ensures an adequate level of quality, rigour and transparency of rating methodologies through other means.

5.6 Disclosure (periodic disclosures about the CRA and competition)

36. With the aim of strengthening competition and limiting the scope for conflicts of interests in the CRA sector, CRA 3 introduced a requirement that fees charged by CRAs for credit ratings and ancillary services should be non-discriminatory and based on actual cost. In its methodology ESMA stated that if this requirement is not in place in the third-country, ESMA considers that there should be other safeguards to ensure that the objectives of avoiding conflicts of interests and promoting fair competition are achieved.

37. The new requirement to fees charged by CRAs is paired with a requirement that CRAs periodically report fees as well as fees schedules to ESMA. In this respect, ESMA expects the third-country legal and supervisory framework to impose some form of disclosure requirement regarding revenue generation by the CRA and that the third-country supervisor has the power to request all the information listed above.

38. Additional information is required to be disclosed to the public in a CRA' annual transparency report. ESMA considers disclosure to the authority is adequate. Furthermore, the level of detail concerning the disclosures do not need to be identical to the EU requirements.

39. Finally, the requirement to preliminary ratings and initial reviews, which was previously limited in scope to credit ratings relating to structured finance instruments, has now been extended to all asset classes. In addition, preliminary ratings and initial reviews should now be reported directly to ESMA. An important objective of this requirement is to limit the risk of rating shopping. However, ESMA considers that this objective may be achieved through other means.

5.7 Disclosure (presentation and disclosure of credit ratings)

40. The CRA Regulation requires that CRAs ensure that credit ratings and rating outlooks are presented and processed in accordance with the requirements set out in Section D of Annex I. In CRA 3 it was clarified that the presentation of a credit rating shall not present factors other than those related to the credit ratings and that the CRA shall stipulates that the rating is the agency's opinion and should be relied upon to a limited degree. A CRA has to accompany the disclosure of rating methodologies, models and key rating assumptions with guidance, which explains assumptions, parameters, limits and uncertainties surrounding the models and rating methodologies used in credit ratings, and which is clear and easily comprehensible.

41. Under the new requirements, a CRA is also required to disclose prominently when it issues an unsolicited credit rating and it shall state prominently in the credit rating whether the rated entity or related third party participated in the credit rating process.

42. As per the MF, ESMA considers that the objectives of transparency and investor protection underlying these requirements can be achieved through other means.

6 Update of assessment of previously assessed jurisdictions

6.1 Argentina

43. This section of the report explains how ESMA assesses equivalence of the legislative and supervisory framework of Argentina with the additional equivalence requirements introduced by the CRA 3 Regulation. The approach adopted has focused on the new provisions of the additional equivalence requirements, identifying the importance of any differences. The relevant Argentinean legal framework in relation to credit rating agencies has not been amended since the updated technical assessment performed in December 2013 (ESMA/2013/1953).

44. As such, this analysis should be read in conjunction with the 2013 Technical Advice on regulatory equivalence [16] and its update (ESMA/2013/1953) which assessed the Argentinean regulatory and supervisory framework against the broader requirements of CRA 1 Regulation, as well as the methodological framework included in Annex III.

45. The following key to references, terms and legislative and supervisory provisions used in this advice:

- CNV: Commission Nacional de Valores;
- CNV Regulation: Title IX of the CNV Regulation adopted in 2001 and amended in 2013 establishing the legal framework for CRAs;
- CML: Capital Markets Law No 26.831.

6.1.1 Scope of the regulatory and supervisory framework (Rating Outlooks)

46. **As regards ensuring that rating outlooks are accurate, transparent and free from conflicts of interest**, the supervisory and regulatory framework for Argentina neither defines nor includes legal provisions related to rating outlooks. As a result, CRAs are not obliged to adhere to any of the requirements as for credit ratings. Nevertheless, CNV has informed ESMA that rating outlooks are a feature of the market in Argentina where the practice is to disclose any changes to these by the means of press releases.

[16] ESMA/2013/626 Technical advice on CRA regulatory equivalence – on Argentina, Brazil, Mexico, Hong Kong and Singapore, Available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-626_esma_technical_advice_on_equivalence_of_argentina_brazil_mexico_hong_kong_singapore_with_eu_on_cras_supervision_30_may_2013.pdf

47. From a supervisory perspective, rating outlooks are not included within the scope of the CNV's supervision of CRAs and consequently, CNV cannot ask for any information related to rating outlooks.

Outlooks

In light of the above, two determinations can be made. The first is that rating outlooks are neither recognised on an explicit or implicit basis in the Argentinean regulatory regime. The second is that rating outlooks are a feature of market for credit ratings in Argentina.

6.1.2 Conflicts of interest management

48. **As regards the effective internal control structures,** Article 9, Title IX of the CNV Regulation requires CRAs to have an administrative and accounting organisation suitable for the fulfilment of their duties. In particular, CRAs must comply with and submit the following documentation in relation to their internal control: description of the mechanisms of internal control designed to guarantee compliance with the decisions and procedures at every level of the CRA, including procedures of adoption of decisions and organisational structures, clearly specifying the information channels and allocating functions and responsibilities.

49. Article 64, Title IX of CNV Regulation additionally requires CRAs to establish adequate and effective organisational and administrative procedures to prevent, detect, eliminate, correct and disclose every conflict of interests. CRAs have to record every significant risk that affect or might affect the independence of the credit rating activities, as well as the protective measures in place to mitigate those risks.

50. **As regards conflicts of interests relating to shareholders**, CRAs are required to take all necessary steps to ensure that the issuing of credit ratings is not affected by either a conflict of interest or a commercial relationship, existing or potential, that involves the CRA itself, its managers, rating committee members, analysts, employees, any other individual whose services are under its control and/or any other individual linked to it directly or indirectly by control (Article 64 , Title IX of CNV Regulation). While there is no explicit reference to shareholders in this provision, the reference to the "CRA itself" and the general requirement to prevent, detect, eliminate, correct and disclose every conflict of interests, seems to indirectly ensure protection against conflicts of interests relating to shareholders.

51. **With regards to the specific ownership thresholds of 10% and 5%:** The fixed thresholds for shareholdings provided for in the CRA Regulation are not reflected within the Argentinean legal framework. There are no similar requirements to prohibit a CRA from issuing a credit rating on an entity which holds more than 10% of its shareholding or from providing consulting or advisory services on an entity which hold more than 5% of its shareholding.

Conflicts of Interest Management

The Argentinean legal and supervisory framework does require a CRA to establish adequate and effective organisational and administrative procedures to prevent, detect, eliminate, correct and disclose every conflict of interest. However, the Argentinean legal framework does not explicitly require CRAs to account for conflicts of interests relating to shareholders. In addition, the 5% and 10% thresholds provided in the CRA Regulation are not replicated.

6.1.3 Organisational requirements (confidentiality)

52. **With regards to whether there is a specific definition of inside information**, Section 117 of Law 26.831 defines inside or non-public information as "*Any specific information referring to one or more securities, or to one or more issuers of securities, which has not been made known to the public or which, if being or having been made public, might materially influence or have influenced the underwriting conditions or price or any course of dealings involving those securities".* In addition, the CNV has confirmed that if any information relating to credit ratings falls under this definition, it is considered as inside information.

53. With regards to whether the definition of inside information is extended to credit ratings, rating outlooks and information thereto, there is no explicit provision which automatically deems credit ratings and information related thereto as inside information, though they may be judged as such if they meet the standards of the definition.

54. **With regards to the internal procedures a CRA is required to put in place,** Article 75 Title IX of CNV Regulations requires CRAs to take care that rating committee members, analysts, employees or any other person under its control do not disclose or misuse any confidential information that they come into possession of. In addition, Annex I of Title IX of the CNV Regulation set out a number of principles that CRAs must follow with respect to the treatment of confidential information.

Confidentiality

The Argentinian regime sets out detailed requirements regarding the steps CRAs must take to protect confidential information in their possession relating to issuers. There is also a credible legislative regime in place protecting against the misuse of inside information. However, it also clear that the Argentine regime does not require that credit ratings and information related thereto be automatically considered as inside information or the Argentine equivalent.

6.1.4 Quality of methodologies and of credit ratings (Quality of credit ratings and analysis of information used in assigning credit ratings)

55. With regards to whether there is a requirement for a credit rating agency to submit a rating to a rated entity for review prior to its publication, the Argentinean legal framework does not contain such a requirement. In view of investor protection and to ensure that the market is informed without delay as to any change in the credit rating, the Argentinean legal framework requires CRAs, after finalising a ratings committee meeting, to immediately publish the credit rating on the CNV's website as well as the CRAs' website (section 61, Title IX of the CNV's Regulation).

Quality of credit ratings and analysis of information used in assigning credit ratings The Argentinean framework takes a very different approach to the EU regime. There is no requirement to give the rated entity an opportunity to provide for a factual check of a credit rating before it is published because a rating must be published as soon as it is approved by the rating committee.

6.1.5 Quality of methodologies and of credit ratings (Quality of methodologies and changes to them)

56. **With regard to the requirement that credit rating changes are issued in accordance with the published methodologies,** the Argentinean legislation explicitly requires CRAs to issue all credit rating in accordance with the published methodology (Article 39, Title IX, CNV Regulation).

57. **With regard to the obligation to consult market participants on material changes to methodologies and publish the responses***,* Article 36, Title IX of CNV Regulation requires CRAs to monitor on an ongoing basis and review their rating methodologies at least once per year. The review is done by independent staff and CNV is informed about the outcome of the review. Should the CRA decide to introduce changes into the rating methodology following the review, the CRA is required to inform CNV about the amendments as well as the ratings affected by the change (Article 37, Title IX of CNV Regulation). However, there is no requirement for CRAs to consult with market participants prior to making a change. As a result, there is also no requirement to publish the responses to a consultation.

58. **With regard to the obligation to correct, publish and report errors in methodologies to the supervisor,** as indicated above, the Argentinean legal framework requires CRAs to monitor on an ongoing basis and review, at least once a year, their methodologies. Article 38, Title IX of CNV Regulation requires that where a methodology is changed as a result of the review process, the CRA should review the affected ratings as soon as possible and not later than six months after the change. CNV deems that, even if there is not a written rule, where errors in the methodology are revealed following such review, the methodology should be accordingly amended. In addition, as the list of information to be submitted to CNV in Article 82, Section IX of CNV Regulation is only

illustrative, the CRA should also inform CNV about errors in methodologies as it might be considered as a "material fact". However, there is no requirement to inform all affected rated entities of errors in the rating methodology or disclose those errors in the CRA's website.

Quality of methodologies

There are some notable differences between the Argentinean regime and the EU regime. There is no requirement for CRAs to consult on changes to their credit ratings, likewise there is no explicit requirement for CRAs to correct errors in their methodologies, although this could be implied by other provisions. There is also no requirement to inform all affected rated entities of errors in a rating methodology. This being said, the requirements that credit ratings are only issued in accordance with published methodologies and that methodologies are reviewed on a periodic basis are present.

6.1.6 Disclosure (Presentation and disclosure of credit ratings)

59. **With regard to the obligations to accompany the disclosure of a methodology underpinning an individual credit rating with guidance**, there are several articles in the Argentinean legal framework that could be seen as achieving the same objective as the EU requirements. Article 40, Title IX of CNV Regulation requires CRAs to include in their rating reports, among others, the indication of the rating methodology used to determine the rating. Additionally, Annex I section 3.3 states that a CRA shall indicate with every rating […] the main methodology or version of the methodology used when determining the rating and where a description of said methodology and other relevant factors to the rating decision can be found. Annex I, section 3.5 requires CRAs to explain in its press releases and reports the basis of issuing or reviewing a credit rating. The purpose of these disclosures is to ensure outside parties can understand how a rating was arrived at by indicating in the credit rating report the methodology used as well as the basis and assumptions.

60. **With regard to the prohibition from including irrelevant elements in the presentation of credit ratings and rating outlooks and the obligation to stipulate that the rating is the agency's opinion and should be relied upon to a limited degree**, the Argentinean legislative framework does not contain such explicit requirements.

61. **With regard to the requirement to indicate whether the rated entity or related third party participated in the credit rating process of issuing an unsolicited rating using a clearly identifiable colour code**, unsolicited credit ratings are not permitted under the Argentinean regime, all credit ratings have to be solicited (Article 58 of the CML).

62. **With regards to whether there is a requirement to disclose on an annual basis details regarding the CRAs' revenues,** Argentinean legislation only requires CRAs to

submit to the CNV and disclose the CRAs' quarterly and annual financial statements. In addition, CNV also publishes this information on its website (Article 83(b)(1) and (2), Title IX of CNV Regulation).

Presentation and disclosure of credit ratings

Under the Argentinian regime there is no explicit requirement for CRAs to only include information relevant to the credit assessment of the entity in a credit rating. There is also no requirement for the CRA to highlight in the credit rating that the rating is the agency's opinion or to provide an annual disclosure detailing the CRAs' revenue. However, there are some provisions in place to ensure that credit ratings are accompanied with sufficient guidance to enable users of ratings to understand them.

6.1.7 Disclosure (Periodic disclosure about the CRA and competition)

63. **With regards to whether there is a requirement for CRAs to disclose on their website and to the CNV on an ongoing basis, information about all entities or debt instruments submitted to it for their initial review or preliminary rating**, Article 83, Title IX of CNV Regulation contains ongoing reporting requirement from CRAs to CNV. In particular, Article 83(b)(3) requires CRAs to submit to CNV within 30 days before every quarter end, the fees charged for their rating services for each client and security indicating if it belongs to an initial or a preliminary rating. However, this information, including whether the rating is initial or preliminary is neither disclosed on CNV's website nor on the CRAs' website.

64. **With regards to the information a CRA is required to provide to the CNV regarding its pricing policies**, among the ongoing reporting requirements to be submitted to CNV according to Article 83, CRAs have to submit the minimum and maximum fees charged for their rating services, differentiating by type of entity, securities, or risks (Article 83(b)(2), Title IX of CNV Regulation). This information is made public by CNV on its website. In addition, letter (b)(3) of the same Article requires CRAs to report on a quarterly basis to CNV about the actual fees charged for their rating service for each client, differentiating the entity and/or instrument and security, the total amount charged in domestic currency and the length and number of staff involved in the rating process. This information is for supervisory purposes and not made public on the CNV's website.

65. **With regards to whether there are any measures in place to ensure that fees charged by the CRA are non-discriminatory and cost based**, the rationale behind the requirement for CRAs to communicate to CNV and publish on its website the minimum and maximum fees charged for their rating services, differentiating by type of entity, of securities, or other risks (Article 83(b)(2) of CNV Regulation), is to provide transparency, non-discriminatory fees and facilitate competition.

66. In addition, amendments introduced in the Argentinean regulatory framework in 2013 tried to **stimulate competition in the credit rating industry** and increase the number

of players. In this regard, public universities are entitled to operate as CRAs provided that they are registered with the CNV and comply with all applicable regulations (Chapter II, Title IX of CNV's Regulations).

Competition and general periodic disclosures

In the area of competition and periodic disclosures the Argentinean legal and supervisory framework seeks to achieve very similar objectives to the EU regime. Specifically, with regards to disclosures in respect of preliminary ratings and fees, the Argentinean regime requires CRAs to provide this information to the regulator, although not to the public. With regards to disclosure of pricing policies, the Argentinean regime requires public disclosure of the minimum and maximum fees to be charged per rating service providing, in order to ensure clients are fairly treated. In addition, the Argentinean regime also contains measures to encourage competition and increase the number of players in the CRA market.

Conclusion

On the basis of this assessment ESMA concludes that the Argentinian legal and supervisory framework does not include sufficient provisions which could meet the objectives of the additional CRA 3 regulatory requirements.

6.2 Australia

67. This section of the report explains how ESMA assesses equivalence of the legislative and supervisory framework of Australia with the additional equivalence requirements introduced by the CRA 3 Regulation. The approach adopted has focused on the new provisions of the additional equivalence requirements, identifying the importance of any differences. The relevant Australian legal framework in relation to CRAs has been amended once since the technical assessment performed in 2012. In 2015, ESMA communicated this change to the European Commission indicating that it had no impact on the technical advice on equivalence of the Australian legal and supervisory framework of 2012.

68. As such, this analysis should be read in conjunction with the 2012 Technical Advice on regulatory equivalence[17] (ESMA/2012/259) which assessed the Australian legal and supervisory framework against the broader requirements of CRA 1 Regulation as well as the methodological framework included in Annex III. The following abbreviations are used throughout this chapter.

- ASIC: Australian Securities and Investment Commission
- AFS: Australian financial services licence
- CA: Corporations Act 2001

6.2.1 Scope of the regulatory and supervisory framework (Rating Outlooks)

69. **As regards ensuring that rating outlooks are accurate, transparent and free from conflicts of interest**, the terms 'credit rating' and 'ratings outlook' are not defined by the Corporations Act 2001 (CA). However, a person who carries on a financial services business in Australia must hold an Australian financial services (AFS) licence that covers the provision of a financial service as laid down in Section s911A of CA.

70. In this regard, a person provides a financial service if they, among other things, provide financial product advice (s766A of CA). Whilst not stated explicitly in the law, ASIC has informed ESMA that credit ratings and ratings outlooks constitute financial product advice under s766B(1) of CA.

71. In practice under the Australian regime, the definition of a credit rating is found in the AFS licenses held by CRAs operating in Australia which authorise an entity to issue a credit rating. In this regard the term 'credit rating' is defined as "a statement, opinion or research dealing with the creditworthiness of a body; or the ability of an issuer of a financial product to meet its obligations under the financial product". While a definition of

[17] ESMA/2012/259 Final report Technical advice on CRA regulatory equivalence - US, Canada and Australia available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2012_-259_0.pdf

rating outlooks is not provided in these licenses, ASIC informed ESMA that it considers rating outlooks to fall within the scope of the definition of a credit rating and thus within the scope of ASIC's supervision of CRAs. ASIC thus considers rating outlooks to be covered by the general requirements in Section 912A(1) of CA such as the requirement to provide financial services efficiently, honestly and fairly and to have in place adequate arrangements for the management of conflicts of interest.

72. In addition, although the AFS licences held by CRAs operating in Australia require compliance with the measures in the IOSCO Code of Conduct[18] (hereinafter: "the IOSCO Code") the IOSCO Code doesn't define rating outlooks or address any requirements to rating outlooks.

Outlooks

There is no explicit recognition of rating outlooks in either the legal (legislative) or supervisory framework (CRA's licenses) of the Australian regime. However, ASIC has confirmed that it considers rating outlooks as falling within the definition of the concept 'financial product advice' and thus within the scope of ASIC's supervisory remit.

6.2.2 Conflicts of interest management

73. **As regards the effective internal control structures**, no identical requirement is found in the Australian legal framework. However, Australian CRAs are subject to a more general requirement to have in place adequate arrangements for the management of conflicts of interest that arise in their business. The Regulatory Guide 181 Licensing sets out in further detail what this implies: ensuring that a licenced entity's internal structures and reporting lines enable it to effectively manage conflicts of interest.

74. **As regards conflicts of interests relating to shareholders,** Section 912A(1)(aa) of CA provides a general rule applicable, inter alia, to CRAs to have in place adequate arrangements for the management of conflicts of interest that arise in their business. However, the obligation does not list the types of conflicts of interest or the parties that must be managed under the licensee's arrangements and thereby does not address explicitly conflicts of interests relating to shareholders. The IOSCO Code which is binding on Australian CRAs provide a wide range of more specific requirements to conflict of interests management relating to analysts and management within the CRA but not shareholders.

75. **With regard to the specific ownership thresholds of 10% and 5%:** The fixed thresholds for shareholdings provided for in CRA 3 are not reflected within the Australian legal framework. There are no similar requirements to prohibit a CRA from issuing a credit rating on an entity which holds more than 10% of its shareholding or from providing consulting or advisory services on an entity which hold more than 5% of its shareholding.

[18] March 2015 revision of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies

In more general terms, the licence terms of an Australian CRA require it to be organised in a manner that ensures its business interest does not impair the independence and accuracy of its credit rating activities.

Conflicts of Interest Management
The Australian regime does not explicitly require CRAs to account for conflicts of interests relating to shareholders. In addition, the 5% and 10% thresholds provided in the CRA Regulation are not replicated in the Australian regime, although the general terms of the licencing terms require the CRA to be organised in a manner that ensures its business interests do not impair the accuracy of its credit rating activities.

6.2.3 Organisational requirements (confidentiality)

76. **With regard to the specific definition of inside information,** Section 1042A of the CA defines "inside information" as information in relation to which the following two conditions are satisfied:

    a. the information is not generally available; and

    b. if the information were generally available, a reasonable person would expect it to have a material effect on the price or value of particular financial products, where financial products include securities, derivatives and other financial products that are able to be traded on a financial market.

77. While there is no explicit provision which automatically deems credit ratings, rating outlooks and information related thereto as inside information, ASIC has confirmed to ESMA that credit ratings and rating outlooks are considered to be inside information before they are disclosed to the public.

78. **With regard to the internal procedures a CRA is required to put in place,** paragraph 3.19 of the IOSCO Code, which is binding under Australian law, requires a CRA to establish, maintain, document and enforce policies, procedures and controls to protect confidential and/or material non-public information, including […] non-public information about a credit rating action (e.g. information about a credit rating action before the credit rating action is publicly disclosed or disseminated to subscribers). This paragraph also provides that the policies, procedures, and controls should require the CRA and its employees to take reasonable steps to protect confidential and/or material non-public information from fraud, theft, misuse, or inadvertent disclosure.

Confidentiality
The Australian regime sets out detailed requirements regarding the steps CRAs must take to protect the confidential information relating to issuers. There is also a credible regime in place protecting against the misuse of inside information. However, it also clear that the Australian regime does not have a provision that deems credit ratings, rating

outlooks and information related thereto to automatically be considered as inside information.

6.2.4 Quality of methodologies and of credit ratings (Quality of credit ratings and analysis of information used in assigning credit ratings)

79. **With regard to whether there is a requirement for a CRA to submit a rating to a rated entity for review prior to its publication**, no time period is prescribed under Australian law. However, paragraph 3.9 of the IOSCO Code, which is binding for Australian CRAs, requires a CRA to, where feasible and appropriate, inform the rated entity, or the obligor or arranger of the rated obligation about the critical information and principal considerations upon which a credit rating will be based prior to disseminating a credit rating that is the result or subject of the credit rating action and provide those parties an adequate opportunity to clarify any factual errors, factual omissions, or factual misperceptions that would have a material effect on the credit rating. The CRA should duly evaluate any response received in that respect.

80. ASIC has not imposed a requirement for the CRAs to give a rated entity a specific period of notice prior to the publication of the credit rating because of concerns that the period of time that the issuer is in possession of the information ahead of the market could be inconsistent with Australian continuous disclosure requirements and/or increase the risk of insider trading.

Quality of credit ratings and analysis of information used in assigning credit ratings

The Australian regime has no explicit requirement for a CRA to inform a rated entity about a credit rating prior to its publication. Instead, a CRA should only notify a rated entity when “feasible and appropriate”. When notifying, there is no minimum time period that the rated entity should be provided.

6.2.5 Quality of methodologies and of credit ratings (Quality of methodologies and changes to them)

81. **With regard to the requirement that credit rating changes are issued in accordance with published methodologies,** a change to a credit rating is treated in the same manner under Australian law as the issuance of a new credit rating: A change to a credit rating as well as a credit rating falls within the definition of 'financial product advice'. Furthermore, paragraph 1.5 of the IOSCO Code requires that analysts, in assessing creditworthiness, use the credit rating methodology established by the CRA for the type of entity or obligation that is subject to the credit rating action and that the methodology be applied in a manner that is consistent across all entities or financial instruments for which that methodology is used.

82. **With regard to the obligation to consult market participants on material changes to methodologies and publish the responses,** there is no requirement in the Australian legal framework for CRAs to consult with market participants prior to making a change. As a result there is also no requirement to publish the responses to a consultation.

83. **With regard to the obligation to correct, publish and report errors in methodologies to the supervisor,** there is a specific condition in the AFS licences held by CRAs entitled: "Arrangements to Monitor and Update Credit Ratings" which requires a CRA, when making a material change to a methodology, to disclose as soon as possible the class of credit ratings that are likely to be affected by the change. The disclosure must be made using the same form of communication as the one used to disseminate the credit rating. However, there is no express requirement to notify the Australian supervisor of an error, unless the error results in a breach of licence condition. CRAs, as AFS licensees, are required to notify ASIC in writing of any significant breaches of their obligations as soon as practicable and in any event within 5 business days of becoming aware of the breach in accordance with section 912D of CA. ASIC confirms that a significant breach could for example be if the credit rating methodology is not rigorous as required by paragraph 1.1 of the IOSCO Code provision or if a methodological contains information which is false or is misleading pursuant to 1041E and H of CA.

84. Failure to correct an identified error in a methodology would, according to the Australian supervisor, likely constitute a breach of paragraph 1.1 of the IOSCO Code which requires a CRA to ensure that it maintains and enforces a credit rating methodology for each class of entity or financial instrument for which the CRA issues credit ratings and that the credit rating methodology is rigorous and capable of being applied consistently. As mentioned above, such a breach would trigger a reporting obligation under Section s912D of CA.

85. There is no express provision in Australian regulations requiring errors in rating methodologies to be disclosed on the website of a CRA but as mentioned above, the CRA is required disclose as soon as possible the class of credit ratings that are likely to be affected by the change.

Quality of methodologies and of credit ratings

The Australian regime requires that ratings are published in accordance with published methodologies. There is also a requirement that rated entities affected by any change to a methodology are informed using the same means of communication. However, there is no requirement for a CRA to consult on a material change to a methodology, there is also no specific requirement to notify the supervisor about an error identified in a methodology or to disclose this on their website.

6.2.6 Disclosure (Presentation and disclosure of credit ratings)

86. **With regard to the obligations to accompany the disclosure of a methodology underpinning an individual credit rating with guidance,** there is no identical provision in the Australian legal framework, but several paragraphs of the IOSCO Code, which is binding on Australian CRAs, provide a similar requirement. According to paragraph 3.13, a CRA should clearly indicate the attributes and limitations of each credit rating, and the extent to which the CRA verifies information provided to it by the rated entity, obligor, or originator, or the underwriter or arranger of the rated obligation. For example, if the credit rating involves a type of entity or obligation for which there is limited historical data, the CRA should disclose this fact and how it may limit the credit rating. In addition, according to paragraph 3.16, when issuing or revising a credit rating, the CRA should explain in its announcement and/or report the key assumptions and data underlying the credit rating, including financial statement adjustments that deviate materially from those contained in the published financial statements of the relevant rated entity or obligor.

87. **With regard to the prohibition from including of irrelevant elements in the presentation of credit ratings and rating outlooks and the obligation to stipulate that the rating is the agency's opinion and should be relied upon to a limited degree**, similar rules are laid down in paragraphs 3.1 and 2.3 of the IOSCO Code. Paragraph 3.1 requires a CRA to assist investors and other users of credit ratings in developing a greater understanding of credit ratings by disclosing in plain language, among other things, the nature and limitations of credit ratings and the risks of unduly relying on them to make investment or other financial decisions. Paragraph 2.3 of the IOSCO Code requires that a CRA's determination of a credit rating to be influenced only by factors relevant to assessing the creditworthiness of the rated entity or obligation.

88. **With regard to the requirement to indicate whether the rated entity or related third party participated in the credit rating process of issuing an unsolicited rating using a clearly identifiable colour code**, paragraph 3.12 of the IOSCO Code requires a CRA to disclose for each credit rating whether the rated entity, obligor, or originator, or the underwriter or arranger of the rated obligation participated in the credit rating process. Each credit rating not initiated at the request of the rated entity, obligor, or originator, or the underwriter or arranger of the rated obligation should be identified as such. However, the rule provides no reference to the use of a colour code.

Presentation and disclosure of credit ratings

The Australian regime requires a CRA to disclose whether a credit rating was solicited and whether the rated entity participated. In addition, there is also a requirement to provide information on any limitations of credit ratings. However, there is no requirement to provide guidance to the public on the methodology behind a credit rating and there is also no requirement to clarify the participation status of solicited ratings via a colour code.

6.2.7 Disclosure (Periodic disclosure about the CRA and competition)

89. **As regards the requirement to disclose on its website and to the supervisor information about all entities or debt instruments submitted to it for their initial review or preliminary ratings**, no corresponding requirement exists in the Australian legal framework. Nevertheless, the Australian supervisor has various powers allowing access to books and records under the ASIC Act including under Section 31, which empowers ASIC to issue a notice to a CRA to produce books in relation to, among other things, advice given, or an analysis or report issued or published, about financial products. Using this power, the Australian supervisor states that it is able to require a CRA, to produce information relating to an initial assessment or a preliminary ratings.

90. With regard to a CRA's internal record keeping obligations, Paragraph 1.9 of the IOSCO Code requires CRA to maintain internal records that are accurate and sufficiently detailed and comprehensive to reconstruct the credit rating process for a given credit rating action. However, there is no explicit requirement to record and document information about preliminary ratings and initial reviews.

91. **With regard to the information a CRA is required to provide to the supervisor on its pricing policies,** no identical requirements for the reporting of pricing policies to supervisor are present in the Australian legal framework. However, the Australian supervisor does have the power to require regulated entities to provide certain related information on their revenues, including to:

    a. direct a licensee to give to ASIC a written statement about the financial services it provides and its financial services business (s912C(1) CA);

    b. require production of books and records relating to the affairs of the CRA for the purposes of ensuring compliance with the corporations legislation (including, for example, compliance with its licence conditions adopting the IOSCO Code or its general licensee obligations regarding management of conflicts of interest) (Section 30 of the ASIC Act); and

    c. require production of books and records relating to the supply of a financial service (Section 32a of the ASIC Act).

92. **With regard to whether there are any measures in place to ensure that fees charged by the CRA are non-discriminatory and cost-based**, no corresponding provision is provided in the Australian legal framework. More broadly, however, CRA licences include a condition entitled: "Prohibition of Anti-Competitive Practices" which provides that where a person other than the licensee has issued a credit rating (other credit rating) which is, or would be, material to the preparation of a credit rating (licensee credit rating) by the licensee in relation to a structured finance product, the licensee must not, for an anti-competitive purpose, do any of the following in relation to the licensee credit rating:

a. issue, or propose to issue, a credit rating that is or would be lower than the credit rating the licensee would have issued had the licensee also prepared the other credit rating;

b. lower, or propose to lower, an existing credit rating if the change or proposed change would not have been made had the licensee also prepared the other credit rating;

c. refuse, or propose to refuse, to issue a credit rating if the refusal or proposed refusal would not have been made had the licensee also prepared the other credit rating;

d. withdraw, or propose to withdraw, a credit rating if the withdrawal or proposed withdrawal would not have been made had the licensee also prepared the other credit rating."

93. **With regards to the public disclosure of financial information of a CRA,** there is no equivalent provision in the Australian legal framework. All licensed CRAs must prepare and file with ASIC an annual profit and loss statement and balance sheet in accordance with Section 989B of CA, which is not made available to the public. In addition, all CRAs must file financial reports with ASIC. The reports filed by larger CRAs are made available to the public for a fee. Small CRAs, however, are exempted from having to disclose this information publicly. Finally, Paragraph 2.8 of the IOSCO Code, requires a CRA to disclose the following data about its revenue streams, including requirements that:

a. a CRA [must] disclose the general nature of its compensation arrangements with rated entities;

b. where a CRA receives from a rated entity compensation unrelated to its ratings service, such as compensation for consulting services, a CRA [must] disclose the proportion such non-rating fees constitute against the fees the CRA receives from the entity for ratings services; and

c. a CRA [must] disclose if it receives 10% or more of its annual revenue from a single issuer, originator, arranger, client or subscriber (including any affiliates of that issuer, originator, arranger, client or subscriber).

94. ASIC interprets the requirement in Paragraph 2.8 of the IOSCO Code to mean that the information should be publicly disclosed.

Competition and general periodic disclosures

The Australian regime has no requirement for CRAs to publicly disclose preliminary ratings. In addition there is no requirement that their fees schedules or fees charged to clients are reported to the supervisor. In addition there are no requirements that fees charged to clients should be cost based and non-discriminatory. With regard to the

requirement to publicly disclose information about the revenue streams of the CRA, there is a requirement that certain information is provided to the Australian supervisor via an annual report. However, there is an exemption from publishing these for small CRAs.

Conclusion

On the basis of this assessment ESMA concludes that the Australian legal and supervisory framework does not include sufficient provisions which could meet the objectives of the additional CRA 3 regulatory requirements.

6.3 Brazil

95. This section of the report explains how ESMA assesses equivalence of the legislative and supervisory framework of Brazil with the additional equivalence requirements introduced by the CRA 3 Regulation. The approach adopted has focused on the new provisions of the additional equivalence requirements, identifying the importance of any differences. The relevant Brazilian legal framework in relation to credit rating agencies has not been amended since the technical assessment performed in May 2013.

96. As such, this analysis should be read in conjunction with the 2013 Technical Advice on regulatory equivalence [19] which assessed the Brazilian regulatory and supervisory framework against the broader requirements of CRA 1 Regulation, as well as the methodological framework included in Annex III.

97. The following key to the references and terms used in this advice:

- CVM: Commission Valores Mobiliarios
- ICVM: Instruction CVM Number 521/2012 (Brazilian CRA Regulation)

6.3.1 Scope of the regulatory and supervisory framework (Rating Outlooks).

98. **As regards ensuring that rating outlooks are accurate, transparent and free from conflicts of interest,** the supervisory and regulatory framework for Brazil does not explicitly recognise rating outlooks in the same way as the EU framework. Article 1 of ICVM defines a credit rating as "an activity in which it emanates an opinion about the credit quality of an issuer of debt or equity, about a structured operation or any other security issued in securities market". According to this, CVM understands a rating outlook to be indistinct from the credit rating to which it is related considering that the rating outlook is an opinion.

99. From a supervisory perspective, CVM expects the production of rating outlooks to adhere to all of the same requirements as the credit ratings of which they are considered. As a result, the rating outlook has to be produced with the same transparency, independence and disclosure requirements.

Outlooks

In light of the above, two determinations can be made. The first is that the Brazil framework is not identical to the EU framework given that it does not explicitly recognise rating outlooks as a separate and distinct item from a credit rating. The second is that

[19] ESMA/2013/626 Technical advice on CRA regulatory equivalence – on Argentina, Brazil, Mexico, Hong Kong and Singapore, Available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-626_esma_technical_advice_on_equivalence_of_argentina_brazil_mexico_hong_kong_singapore_with_eu_on_cras_supervision_30_may_2013.pdf

functionally the Brazilian framework results in the same objectives in practice concerning the effective supervision of credit rating activities and the consequences for investor protection.

6.3.2 Conflicts of interest management

100. **As regards the effective internal control structures,** Article 19 of the ICVM requires that a CRA establishes an internal Code of Conduct (CoC). This internal CoC should be made publicly available. Article 20 of the ICVM requires that the CoC adopted by a CRA contains, among other requirements, the adoption of mechanisms to identify, eliminate, manage and disclose situations involving conflict of interests when carrying out its credit rating activity. Further to this, Article 25 of the ICVM requires CRAs to specify sanctions in case of an infringement of the CoC.

101. **As regards conflicts of interests relating to shareholders**, the most relevant provision is Article 22 of ICVM that prohibits a CRA to issue a credit rating if: a) the CRA, the credit rating analysts or other individuals involved in the credit rating process have, directly or indirectly, financial assets of the entity which is being rated or of any related third party; b) the rated entity or related third party is directly or indirectly part of the controlling block of the credit rating agency; […]. While there is no explicit reference to shareholders in this provision, it could be argued that CRAs are required to address conflicts of interest relating to their shareholders on an implicit basis on account of the reference to the "CRA itself" and the general requirement to prevent, detect, eliminate, correct and disclose every conflict of interest. This could be interpreted as indirectly ensuring protection against conflicts of interest relating to shareholders.

102. **With regards to the specific ownership thresholds of 10% and 5%:** Concerning whether a CRA is prohibited from issuing a credit rating on an entity if a board member of the CRA or a shareholder holding more than 10% of shares or voting rights of the CRA also holds more than 10% of the shares in the rated entity, there is no like for like provision. However, letter (e) of Article 22 of ICVM contains a general prohibition for CRAs to issue or maintain a credit rating in case of rating analysts or any other person involved in the issuance of the rating maintained any kind of relationship which could give rise to conflict of interests with the rated entity or any related party; [...]". In addition, Article 16 of ICVM requires that credit rating reports must disclose any situations that may create potential conflict of interest. In this regard, Paragraph 2 of this Article provides an example of a situation that may create a conflict of interest as being "where the CRA, the credit rating analysts or any person involved in a given credit rating process, its spouses, partners or any dependents have relevant financial or commercial interests in relation to the rated entity". CVM considers that on an implicit basis this could be also understood as referring to shareholders. However this is not as strong as a prohibition.

103. Regarding whether there is a prohibition on an individual or entity holding more than 5% of the shares or the voting rights of a CRA from proving consultancy or advisory services to a rated entity of that CRA, there is no explicit prohibition. However, Article 16 of the

ICVM requires CRAs to disclose any potential conflict of interest and in particular, any services provided to the rated entity, CRA, or related third parties in the last 12 months.

Conflicts of Interest Management

The Brazilian legal framework does not explicitly require CRAs to account for conflicts of interest relating to shareholders. In addition, the 5% and 10% thresholds provided in the CRA Regulation are not replicated in the Brazilian legal framework, although there does exist a requirement for CRAs to disclose any potential conflicts of interest that may have arisen in respect of a rated entity (or related third party) in the previous 12 months.

6.3.3 Organisational requirements (confidentiality)

104. **With regards to whether there is a specific definition of inside information**, there is a definition of inside information in the Brazilian legal framework which defines privileged information "as any material information not yet released to the public that anyone may receive and shall not make use of to obtain any advantages".

105. With regards to whether the definition of inside information is extended to credit ratings, rating outlooks and information thereto, there is no explicit provision which automatically deems credit ratings, rating outlooks and information related thereto as inside information, though they may be judged as such if they meet the standards of the definition.

106. **With regards to the internal procedures a CRA is required to put in place,** ESMA has been informed by the CVM that it would expect CRA's Codes of Conduct to observe the principles of the IOSCO CRA Code of Conduct with regards to the treatment of confidential information.

Confidentiality

The Brazil regime has a definition of inside information and there is a legislative regime in place to protecting against the misuse of inside information. However, it is also clear that the Brazilian regime does not automatically consider credit ratings, rating outlooks and information related to be inside information, or the Brazilian equivalent.

6.3.4 Quality of methodologies and of credit ratings (Quality of credit ratings and analysis of information used in assigning credit ratings)

107. **With regards to whether there is a requirement for a credit rating agency to submit a rating to a rated entity for review prior to its publication**, the Brazilian legal framework does not require CRAs to inform the rated entity before the credit rating is published. However, Article 16, section IX, of ICVM requires that, in case the CRA chooses to inform the rated entity before the credit rating report is made public, the CRA

has to disclose in the report whether the final rating was changed due to a rated entity comment or correction.

Quality of credit ratings and analysis of information used in assigning credit ratings The Brazilian framework has no requirement to provide a credit rating to a rated entity for factual check prior to publication. However, should a CRA choose to present a rating to the rated entity for review, the Brazilian regime requires this information to be disclosed as part of the rating.

6.3.5 Quality of methodologies and of credit ratings (Quality of methodologies and changes to them)

108. **With regard to the requirement that credit ratings are issued in accordance with the published methodologies**, Article 15 of the ICVM requires that the credit rating is produced strictly following the procedures and methodologies adopted by the CRA. In addition, Article 16 of the ICVM that CRAs should indicate in each credit rating report the methodology that was used in determining the credit rating. This would therefore appear to establish that it is a requirement for credit ratings to be issued in accordance with an existing or published methodology.

109. **With regard to the obligation to consult market participants on material changes to methodologies and publish the responses**, the Brazilian legal framework states that a CRA should disclose to the regulator and the market any material change to its methodologies. Article 14 of ICVM requires CRAs to file with CVM, through the electronic system available at CVM's website, among other information, […] relevant changes in methodologies, procedures and criteria utilized in credit ratings, as well as new methodologies, 7 business days after approval. In addition, where a significant change is introduced in methodologies and procedures, Article 30 of ICVM requires CRAs to immediately disclose that. However, there is no requirement for CRAs to consult with market participants prior to making a change. As a result there is also no requirement to publish the responses to a consultation.

110. **With regard to the obligation to correct, publish and report errors in methodologies to the supervisor,** there is no explicit requirement in the ICVM for a CRA to address any errors in its methodologies. However there is the general requirement set out in Article 29 of the ICVM that CRAs have to review, at least annually, their methodologies and models. Should the CRA introduce significant changes to rating methodologies, the CRA is required to disclose these immediately. However, there is not explicit requirement to disclose the reason why the methodology has been changed (for example, due to an identified error).

111. **With regards to requirements to notify affected rated entities or the supervisor, Article 30 of ICVM specifies that where a significant change is introduced in a rating methodology**, the CRA has to immediately disclose, using the same means of communication as used for distributing the ratings, the list of credit ratings likely to be

affected. While this is not an explicit requirement to inform all affected rated entities it is possible it would result in the same outcome. With regards to whether there is a requirement to notify the supervisor, there is no such a requirement under the ICVM.

Quality of methodologies and changes to them
Under the Brazilian regime, there is a requirement that credit ratings should be published according to a published methodology. However, there are no requirements to consult on changes to methodologies, there are also no explicit requirements to correct any errors in their methodologies. While there is a requirement to communicate the scope of rated entities affected by a change to a methodology, there is no requirement to notify the supervisor.

6.3.6 Disclosure (Presentation and disclosure of credit ratings)

112. **With regards to the obligation to accompany the disclosure of a methodology underpinning an individual credit ratings with guidance**, Article 16 of ICVM requires that credit rating reports to include methodologies used to determine the credit rating. In addition, CRAs have to publish their rating methodologies. The purpose of these disclosures is to ensure outside parties can understand how a rating was arrived at by a CRA.

113. **With regards to the prohibition from including irrelevant elements in the presentation of credit ratings and rating outlooks and the obligation to stipulate that the rating is the agency's opinion and should be relied upon to a limited degree**, Article 10 of the ICVM requires CRAs to adopt measures to avoid the disclosure of any credit rating that contains false statements or mislead the user about the situation of an issuer or financial instrument. In addition, this Article also requires that all information disclosed by a CRA has to be written in a simple, clear, objective and concise manner. However, there is no requirement to stipulate in the rating that is the agency's opinion and should be relied upon to a limited degree.

114. **With regard to the requirement to indicate whether the rated entity or related third party participated in the credit rating process using a clearly distinguishable different colour code for the rating category**, there is no such requirement under the Brazilian framework.

115. **With regards to whether there is a requirement to disclose on an annual basis details regarding the CRAs revenue,** Annex 13 of ICVM 521/12 requires CRAs to disclose in relation to each operational segment (financial institutions, government, insurance, structured finance instruments, corporates, securities and others) the following information (a) products and services commercialized; (b) percentage of net income from each segment and (c) number of issuers, structured operations, debt securities or any other securities rated by the CRA, for each segment.

Presentation and disclosure of credit ratings

Under the Brazilian there is no requirement to indicate that a credit rating is the agency's opinion and should only be relied upon to a limited degree. There are also no requirements to indicate the participation of a rated entity in the rating process by colour code, there is however a requirement to disclose information on revenues on an annual basis.

6.3.7 Disclosure (Periodic disclosure about the CRA and competition)

116. **With regards to whether there is a requirement for CRAs to disclose on their website and to the CVM on an ongoing basis, information about all entities or debt instruments submitted for their initial review or preliminary rating**, the relevant provision with regards to the Brazilian legal framework is Article 12 of the ICVM. Once the underlying operation is disclosed, this provision requires CRAs to publish on their website any preliminary ratings that were not used by the rated entity even if the CRA was not contracted to issue the final rating.

117. **With regards to the information a CRA is required to provide to the CVM regarding its pricing policies,** there are no systematic requirements in the Brazilian framework to provide pricing policies of the CRA to either the supervisor or to the public. However, CVM may request this information as part of its supervisory activities. As such, Article 9 of the Federal Law 6385/76 empowers CVM to examine and extract copies of accounting records, books or documents, including electronic software and magnetic files, optical or of any other nature, as well as working papers of external audits from any natural or legal entity, when there is any potential irregularity to be verified. In order to ensure there is some degree of transparency towards the market, ICVM requires CRAs to disclose, to CVM and the market the revenues for clients representing more than 5% of the total revenue.

118. **With regards to whether there are any measures in place to ensure that fees charged by the CRA are non-discriminatory and cost based**, there are no similar requirements in the Brazilian legal framework.

Competition and general periodic disclosures

The Brazilian legal framework has similar requirements to the EU regime for preliminary ratings. However, with regards to disclosures of pricing policies to the supervisor and the market, there are no similar requirements under the Brazilian regime. Regarding the measures to protect clients and ensure they are fairly treated, there are no similar requirements under the Brazilian regime.

Conclusion

On the basis of this assessment ESMA concludes that the Brazilian legal and supervisory framework does not include sufficient provisions which could meet the objectives of the additional CRA 3 regulatory requirements.

6.4 Canada

119. This section of the report explains how ESMA assesses equivalence between the Canadian legal and supervisory framework and the EU regulatory regime for CRAs concerning the new CRA 3 requirements. The structure of the section follows the main areas where CRA 3 introduced changes. It should be read in conjunction with the 2012 Technical Advice on regulatory equivalence[20] which assessed the Canadian legal and supervisory framework against the broader requirements of CRA 1 Regulation.

120. ***IMPORTANT:*** *The assessment of the Canadian legal and supervisory framework is based on a legislative proposal for amendments to the existing Canadian legislation. This means that the conclusion of this assessment is contingent on the exact text of the proposed rule change being adopted and implemented into law before 1 June 2018. If the text of the legislative proposal is revised before final adoption, ESMA will produce an addendum to this advice, on the basis of the final adopted text.*

121. The following key to the references and terms used in this advice:

- DRO: A registered CRA is known under Canadian law as a "Designated Rating Organization" abbreviated DRO.
- The Canadian Rules: National Instrument 25-101 Designated Rating Organizations (NI 25-101)

6.4.1 Scope of the regulatory and supervisory framework (Rating Outlooks)

122. **As regards the approach adopted to regulating rating outlooks**, the Canadian legal framework mirrors the approach to rating outlooks taken in the CRA Regulation. First, Section 1 of the Canadian Rules contains a definition of a rating outlook which except for replacing the word "opinion" by "assessment" is identical to the European definition: an assessment regarding the likely direction of a credit rating over the short term, the medium term or both. Second, the reference to rating outlooks has been introduced throughout the Canadian Rules including for provisions relating to the accuracy and disclosure of ratings, to the independence and conflicts of interests, and to the protection of confidential information.

123. Finally, when disclosing a rating outlook, a DRO must in accordance with Sections 2.13.1 and 2.13.2 of appendix A to the Canadian Rules indicate the time period during which a change in the credit rating may occur and where the historical performance can be accessed on its website.

[20] ESMA/2012/259: Final report Technical advice on CRA regulatory equivalence - US, Canada and Australia, available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2012_-259_0.pdf

Rating Outlooks

In light of the above, the determination that rating outlooks are recognised on an explicit basis in the Canadian regime can be made. In addition the Canadian regime's definition of rating outlooks very closely mirrors the EU definition.

6.4.2 Conflicts of interest management

124. **As regards the requirement to have effective internal control structures**, similar rules to the EU regime are set out in the Canadian legal framework. The Canadian Rules make no mention of "standard operating procedures". However, the combined effect of Sections 2.26 and 3.11.1 of Appendix A to the Canadian Rules ensures a level of quality of corporate governance which matches that required from an EU CRA. Section 2.26 requires that a DRO designs reasonable administrative and accounting procedures, internal control mechanisms, including internal control mechanisms in relation to the policies and procedures set out in Section 3.11.1. Section 3.11.1 requires a DRO to adopt, implement and enforce policies and procedures to prevent and mitigate conflicts of interests and to ensure the independence of credit ratings, rating outlooks and DRO employees. These policies and procedures must be monitored and reviewed periodically.

125. **As regards conflicts of interests relating to shareholders,** the Canadian Rules provide no identical reference to shareholders. However, the Canadian supervisor has indicated to ESMA that shareholders are covered under the reference to "*any other person or company*" in Section 3.4 of Appendix A to the Canadian Rules which prohibits a DRO from allowing its decision to assign a credit rating or rating outlook to a rated entity or rated securities to be affected by the existence of, or potential for, a business relationship between the DRO or its affiliates and any other person or company including, for greater certainty, the rated entity, its affiliates or related entities.

126. Section 3 of the Canadian Rules defines what constitutes a person or company which is an affiliate of another person or company is provided for the purpose of the rules applicable to CRAs: I.e. when one of them is the subsidiary of the other and when each of them is controlled by the same person or company. In this context, control is considered to exist between two persons/companies when any of the following apply:

    a. the first person beneficially owns, or controls or directs, directly or indirectly, securities of the second person carrying votes which, if exercised, would entitle the first person to elect a majority of the directors of the second person, unless that first person holds the voting securities only to secure an obligation;

    b. the second person is a partnership, other than a limited partnership, and the first person holds more than 50% of the interests of the partnership;

    c. the second person is a limited partnership and the general partner of the limited partnership is the first person.

127. **With regard to the specific ownership thresholds of 10% and 5%,** the Canadian Rules are very close to the EU rules. The requirement in paragraph 3(aa) of Section B of Annex I of CRAR is met in by Section 3.6.1 of Appendix A to the Canadian Rules which prohibits a DRO from assigning a rating or a rating outlook to person or a company if:

a. a significant security holder of the DRO, or of an affiliate that is a parent of the DRO, is a significant security holder of the person or company, its affiliates or related entities; or

b. an officer or director of a significant security holder of the DRO, or of an affiliate that is a parent of the DRO, is an officer or director of the person or company, its affiliates or related entities.

128. Section 1 of the Canadian Rules defines a significant security holder as a person or company that has beneficial ownership of, or control or direction over, whether direct or indirect, or a combination of beneficial ownership of, and control or direction over, whether direct or indirect, securities of an issuer carrying more than 10 per cent of the voting rights attached to all of the issuer's outstanding voting securities.

129. Section 2.20 of Appendix A to the Canadian Rules also prohibit a significant security holder of DRO or of an affiliate that is a parent of the DRO from making recommendations to a rated entity about its corporate or legal structure, assets, liabilities or activities. Whilst the threshold is set at 5% ownership in the CRA Regulation, the Canadian Rules only apply to shareholders with at least 10% of the voting rights attached to all of the issuer's outstanding voting securities.

Conflicts of interest management

Similar to the CRA Regulation, the Canadian legal framework requires a CRA to establish reasonable administrative and accounting procedures and internal control mechanisms to protect against conflicts of interests. However, the Canadian legal framework does not explicitly refer to shareholder conflicts of interests in its rules but rather conflicts of interests relating to "any other person or company" which according to the Canadian supervisor covers shareholders. In addition, the 5% and 10% thresholds provided in the CRA Regulation are mirrored in the Canadian legal framework except the 5% limit is set at 10%.

6.4.3 Organisational requirements (confidentiality)

130. **With regard to whether there is a specific definition of inside information**, the terms "material fact" and "material change" are defined in securities legislation in Canada. As a general matter, there are insider trading and tipping restrictions in securities legislation in Canada that apply to certain persons who have access to material facts or material changes about a reporting issuer (public company) before that material information is publicly disclosed. Securities regulators have given guidance in National Policy 51-201

Disclosure Standards that such material information may, depending on the circumstances of the reporting issuer, include changes in a CRA's decisions. For this reason, Section 4.16.1 of Appendix A to the Canadian Rules requires a DRO to consider applicable securities legislation governing insider trading or tipping when dealing with non-public information that it receives from an issuer.

131. **With regard to whether the definition of inside information is extended to credit ratings, rating outlooks and information thereto,** whilst this is not stated explicitly, it is implicit from Section 4.16.1 of Appendix A to the Canadian Rules which requires a DRO to maintain a list of all persons who have access to non-public information about a credit rating action, including information about a credit rating action before the credit rating or rating outlook is publicly disclosed or disseminated to subscribers. For any credit rating action, the list must include applicable DRO employees and any person identified by the rated entity for purposes of the list.

132. Section 4.19 of Appendix A to the Canadian Rules requires a DRO to ensure that the DRO and its employees do not engage in transactions in securities, derivatives or exchange contracts when they possess confidential information concerning the issuer of such security or to which the derivative or the exchange contract relates, including information about a credit rating action before the credit rating or rating outlook is publicly disclosed or disseminated to subscribers.

133. **With regard to the internal procedures a CRA is required to put in place**, the Canadian rules provide a very high level of protection of confidential information. Section 4.16 of Appendix A to the Canadian Rules requires a DRO and its employees to take all reasonable measures to protect non-public information about a credit rating action, including information about a credit rating action before the credit rating or rating outlook is publicly disclosed or disseminated to subscribers. Section 4.16 also provides that, subject to certain exceptions, a DRO and its employees must not disclose confidential information, including information about a credit rating action before the credit rating or rating outlook. In addition to the above requirements, additional requirements apply when the rated issuer is a "reporting issuer" (public company) under applicable securities legislation in Canada.

134. Finally, Section 4.20 of Appendix A to the Canadian Rules requires the employees to have familiarised with the DRO's internal securities trading policies and certify compliance at regular intervals.

Confidentiality

The prohibition from disclosing any non-public information about a credit rating action before it is published is very broad as it is not limited to "material" information. Furthermore, the Canadian framework, requires a list all persons who have access to non-public information about a credit rating action, including information about a credit rating action before the credit rating or rating outlook is publicly disclosed or disseminated to subscribers mirroring the European requirement. Finally a reference to

applicable securities legislation in Canada when rated issuer is a “reporting issuer” (public company) links the Canadian rules to insider trading rules.

6.4.4 Quality of methodologies and of credit ratings (Quality of credit ratings and analysis of information used in assigning credit ratings)

135. **With regard to whether there is a requirement for a credit rating agency to submit a rating to a rated entity for review prior to its publication**, the Canadian Rules contain a provision in Section 4.12 of Appendix A, which requires a DRO to inform the issuer of the critical information and principal considerations upon which a credit rating or rating outlook will be based.

136. While the Canadian Rules, similarly to the European rule, requires a DRO to contact the rated entity during its business hours, the Canadian Rules do not guarantee the rated entity 24 hours to respond. Instead, a more principle-based approach is adopted requiring the DRO to “afford the issuer a reasonable opportunity to clarify any likely factual misperceptions or other matters that the DRO would want to be made aware of in order to produce an accurate credit rating or rating outlook”.

Quality of credit ratings and analysis of information used in assigning credit ratings

The Canadian framework is different to that of the EU wherein there is a principles based approach to the amount of time that a rated entity should be provided. In this regard the EU regime requires “a full working day” whereas the Canadian requirement is for “a reasonable amount of time”.

6.4.5 Quality of methodologies and of credit ratings (Quality of methodologies and changes to them)

137. **With regard to the requirement that credit rating changes are issued in accordance with published methodologies**, a nearly identical requirement is provided in Section 2.13.1 of Appendix A of the Canadian Rules, which states that a change in ratings must be made in accordance with the DRO’s published rating methodologies.

138. **With regard to the obligation to consult market participants on material changes to methodologies and publish the responses,** the Canadian rules provide requirements which are very similar to the EU requirements in Sections 4.15.1 and 4.15.2 of Appendix A.

139. Section 4.15.1provides that if a DRO intends to make a significant change to an existing rating methodology, model or key rating assumption or use a new rating methodology that could have an impact on a credit rating, the DRO must do both of the following:

a. Publish the proposed significant change or proposed new rating methodology on its website together with a detailed explanation of the reasons for, and the

implications of, the proposed significant change or proposed new rating methodology;

b. Invite interested persons to submit written comments with respect to the proposed significant change or proposed new rating methodology within a period of at least 30 days after the publication.

140. In addition, Section 4.15.2 of Appendix A to the Canadian rules requires that a DRO if, following the publication referred to above, the DRO makes a significant change to an existing rating methodology, model or key rating assumption or issues a new rating methodology that could have an impact on a credit rating, the DRO must promptly publish the following information on its website:

a. The revised or new rating methodology, model or key rating assumption,

b. A detailed explanation of the revised or new methodology, model or key rating assumption, its date of application and the results of the consultation referred to in Section 4.15.1;

c. Copies of the written comments referred to in Paragraph 4.15.1(b), except in the case where confidentiality is requested by the person who submitted the comment.

141. **With regard to the obligation to correct, publish and report errors in methodologies to the supervisor**, the requirements laid down in Section 2.12.1 of Appendix A to the Canadian Rules are nearly identical to the EU requirements: if a DRO becomes aware of errors in a rating methodology or its application, the DRO must do all of the following if the errors could have an impact on its ratings:

a. Promptly notify the regulator or securities regulatory authority and all affected rated entities of the errors and explain the impact or potential impact of the errors on its ratings, including the need to review existing ratings;

b. Promptly publish a notice of the errors on its website, where the errors have an impact on its ratings;

c. Promptly correct the errors in the rating methodology or the application;

d. Apply the relevant measures as if the correction of the error were a change contemplated by that section.

Quality of methodologies and changes to them

With the exception of a few minor differences the Canadian rules with regards to the quality of credit rating methodologies are in style and content very close to the European rules.

6.4.6 Disclosure (Presentation and disclosure of credit ratings)

142. **With regard to the obligations to accompany the disclosure of a methodology underpinning an individual credit rating with guidance**, a nearly identical provision is found in the Canadian Rules. When disclosing the methodologies, models and key rating assumptions, Section 4.8.1 of Appendix A to the Canadian Rules requires a DRO to include guidance using plain language that explains assumptions, parameters, limits and uncertainties surrounding the methodologies and models it uses in its credit rating activities, including simulations of stress scenarios undertaken by the r when determining credit ratings, information on cash-flow analysis it has performed or is relying upon and, where applicable, an indication of any expected change in the credit rating.

143. **With regard to the prohibition from including irrelevant elements in the presentation of credit ratings and rating outlooks and the obligation to stipulate that the rating is the agency's opinion and should be relied upon to a limited degree**, very similar requirements have also been included in the proposed Canadian Rules. Section 4.10 of Appendix A states that a DRO, when issuing a credit rating or a rating outlook, must disclose that the credit rating or rating outlook is the DRO's assessment and should only be relied on to a limited degree. Section 3.3 of Appendix A prohibits the determination of a credit rating or rating outlook from being influenced by factors other than those that are relevant to the credit assessment.

144. **With regard to the requirement to indicate whether the rated entity or related third party participated in the credit rating process using a clearly when issuing an unsolicited rating using a colour code**, this requirement is replicated in Section 4.14 of Appendix A. According to this rule a DRO must disclose, for each credit rating, whether the rated entity and its related entities participated in the rating process and whether the DRO had access to the accounts, management and other relevant internal documents of the rated entity or its related entities. Each credit rating without those characteristics must be identified as such using a clearly distinguishable colour code for the rating category.

Presentation and disclosure of credit ratings

With regards to the obligation to provide guidance alongside a methodology, the Canadian regime is very similar to the EU regime. With regards to the requirements that CRAs state that credit ratings should only be relied on to a limited degree and that credit ratings should be limited to factors relevant to credit assessment, the two regimes are also closely aligned.

6.4.7 Disclosure (Periodic disclosure about the CRA and competition)

145. **With regards to whether there is a requirement for CRAs to disclose on their website and to the local supervisor on an ongoing basis, information about all entities or debt instruments submitted for their initial review or preliminary rating,** similar provisions are provided in the Canadian Rules. Section 4.7 of the Canadian Rules

requires a DRO to disclose on an ongoing basis information about all debt securities and structured finance products submitted to it for its initial review or for a preliminary rating, including whether the issuer requested the DRO to provide a final rating. Two small differences can be identified. First, reporting of this information directly to the supervisor is not required. Second, ratings relating to a legal entity itself (as opposed to debt issues and structured finance instruments issued by that entity) appear to fall outside the scope of the Canadian requirement.

146. With regard to the information a CRA is required to provide to the supervisor regarding its pricing policies and the specific fees charged to clients, the Canadian Rules require that a DRO provides some of this information to the supervisor. FORM 25-101F1 (a form which a DRO applicant and a DRO is required to file under the Canadian Rules) lists the information which a DRO applicant must provide its application and subsequently in its annual filings to the regulator. Item 14A of this form requires disclosure of the DRO's pricing policy for credit rating services and any ancillary services, including the fee structure and pricing criteria in relation to credit ratings for different asset classes. This information has to be resubmitted annually. However, the Canadian Rules do not require a DRO to submit details of fees charged to individual clients. The supervisor has submitted that if it wanted to conduct a compliance review on fees charged by a DRO, it has the power to request that information under section 20 of the Securities Act (Ontario).

147. **With regard to whether there are any measures in place to ensure that fees charged by the CRA are non-discriminatory and cost based,** Section 3.9.1 of Appendix A to the Canadian Rules contain a similar requirement for a DRO to ensure both of the following:

    a. Fees charged to rated entities for the provision of credit ratings and ancillary services, as referred to in Section 3.5, do not discriminate among rated entities in an unfair manner and have a reasonable relation to actual costs;

    b. Fees charged to rated entities for the provision of credit ratings must not depend on the category of credit rating or any other result or outcome of the work performed.

148. **With regard to whether there is a requirement to disclose on an annual basis details regarding the CRAs revenue,** the Canadian Rules require a DRO to provide certain information to the supervisor. Form 25-101F1 (a form which a DRO applicant and a DRO is required to file under the Canadian Rules) lists the information which a DRO applicant must provide in its application and a DRO must provide in an annual form to the regulator. Item 13 of this form requires the disclosure of a range of financial information including, as applicable, for the most recently completed financial year:

    a. Revenue from determining and maintaining credit ratings,

    b. Revenue from subscribers,

c. Revenue from granting licenses or rights to publish credit ratings, and

d. Revenue from all other services and products offered by the credit rating organisation (include descriptions of any major sources of revenue).

149. Furthermore, Item 13 of the form requires the DRO to include financial information about the revenue of the DRO separated into fees from credit rating services and non-credit rating services, including a comprehensive description of each. In providing this information, the DRO must disclose the following:

a. Revenue from non-credit rating services provided to persons that also obtained credit rating services,

b. Revenue from credit rating services for different asset classes, and

c. Revenue from credit rating services and non-credit rating services provided to persons located in Canada.

Competition and general periodic disclosures

The requirements in the Canadian legal framework broadly reflect those in the CRA Regulation. Fees schedules are to be provided annually to the Canadian supervisor but not the actual fees charged. This information, however, is to be kept on file for review by the supervisor in case of investigations. A CRA is not required to make public disclosures annually about its revenues, but to provide this information to the supervisor. Preliminary ratings and initial assessments are to be published for all asset classes, but not for ratings relating to legal entities (only financial instruments). Furthermore, this information need not be reported to the supervisor. Finally, the Canadian rules apply a slightly different language in its requirement regarding discrimination and relation to costs of the fees charged by a DRO, nevertheless, achieving the same objective.

Conclusion

On the basis of this assessment ESMA concludes that the Canadian legal and supervisory framework includes sufficient provisions to meet the objectives of the additional CRA 3 regulatory requirements.

6.5 Hong Kong

150. This section of the report explains how ESMA assesses equivalence of the legislative and supervisory framework of Hong Kong with the additional equivalence requirements introduced by the CRA 3 Regulation. The approach adopted has focused on the new provisions of the additional equivalence requirements, identifying the importance of any differences.

151. As such, this analysis should be read in conjunction with the 2013 Technical Advice on regulatory equivalence[21] which assessed the Hong Kong regulatory and supervisory framework against the broader requirements of CRA 1 Regulation, as well as the methodological framework in Annex III.

152. In this regard, the following are the legislative and supervisory provisions that were assessed:

- SFO - Securities and Futures Ordinance (SFO);
- Code of Conduct for Persons Providing Credit Rating Services (CoC) ;
- Securities and Futures (Financial Resources) Rules (FRR).

6.5.1 Scope of the regulatory and supervisory framework (Rating Outlooks)

153. **As regards the approach adopted to regulating rating outlooks**, the supervisory and regulatory framework for Hong Kong does not explicitly recognise rating outlooks in the same way as the EU framework. In practical terms, rating outlooks are issued by CRAs together with credit ratings in ratings announcements or reports, and are therefore regarded as part of the outcome of the credit rating process. As such, the Hong Kong regulatory and supervisory framework expects the production of rating outlooks to adhere to all of the same requirements for credit ratings of which they are considered a crucial part.

154. The legal basis for this approach is the broad nature of the term “credit rating” under the Hong Kong framework[22] which, for the purposes of supervision, is understood to encompass the EU Regulation’s terms for “credit ratings” and “rating outlooks”. From a supervisory perspective, ESMA has been informed the Hong Kong supervisor considers that rating outlooks should be produced according to the same standards as credit ratings and are included as part of their risk-based supervisory reviews.

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[21] ESMA/2013/626 Technical advice on CRA regulatory equivalence – on Argentina, Brazil, Mexico, Hong Kong and Singapore, Available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-626_esma_technical_advice_on_equivalence_of_argentina_brazil_mexico_hong_kong_singapore_with_eu_on_cras_supervision_30_may_2013.pdf

[22] Credit Rating” means opinions, expressed using a defined ranking system, primarily regarding the creditworthiness of – (a) a person other than an individual (b) debt securities (c) preferred securities (d) an agreement to provide credit.

Outlooks

The Hong Kong framework is not identical to the EU framework as it does not explicitly recognise rating outlooks as a separate and distinct item from credit ratings. However, the broad nature of the term “credit rating” under Hong Kong framework results in the same objectives in practice as it is understood as extending to include rating outlooks.

6.5.2 Conflicts of interest management

155. The SFO and its subsidiary legislation, and also the codes and guidelines published by the SFC under the SFO, particularly the CoC, set out the framework to identify and eliminate or alternatively manage and disclose conflicts of interest.

156. **As regards the effective internal control structures,** Paragraph 32 of the CoC requires CRAs to adopt written internal procedures to (a) identify and (b) eliminate, or manage and disclose, as appropriate, any actual or potential conflicts of interest that may influence the CRAs ratings or the judgement of its analysts. The requirement to develop these internal policies and procedures is accompanied by a requirement for these to be disclosed by the CRAs set out in Part 4 of the CoC.

157. **As regards conflicts of interests relating to shareholders**, Paragraphs 29, 30 and 32 of the CoC require the CRA to establish appropriate and effective arrangements as to prevent, identify and eliminate or manage and disclose conflicts of interest and to be organised in a manner that ensures they are not affected by business relationships. In particular, a CRA should not carry on any business that could reasonably be considered to have the potential to give rise to any conflict of interest in relation to its business of providing credit rating services[23]. Even though there is no explicit reference to shareholders in this provision, if there is a reasonable potential for a conflict of interest then the CRA is prohibited from carrying out that business.

158. **With regards to the specific ownership thresholds of 10% and 5%,** the fixed thresholds for shareholdings provided for in the CRA Regulation are not reflected within the Hong Kong framework and there is no similar requirement to prohibit a licensed CRA form issuing a credit rating on an entity which holds more than 10% of its shareholding. However, given the dual nature of a CRA’s registration status in Hong Kong, as both a licensed corporation as well a CRA, they are also subject to Schedule 1, Part 1, Section 6, of the SFO which adopts a 10% shareholding as the threshold to determine whether a party is a substantial shareholder of a corporation. Therefore, as a result of the applicability of this legislation the SFC would likely apply this threshold as a factor when considering an issue relating to conflicts of interest.

[23] Paragraph 30 of the CRA Code

Conflicts of Interest Management

Similar to the EU regime, the Hong Kong legal and supervisory framework requires a CRA to establish adequate and effective organisational and administrative procedures to prevent, detect, eliminate, correct and disclose every conflict of interest.

However, the Hong Kong legal framework does not explicitly require CRAs to account for conflicts of interests relating to shareholders. In addition, the 5% and 10% thresholds provided in the CRA Regulation are not replicated in the Hong Kong legal framework, although there does exist the possibility that a shareholder with 10% or more would be judged as being in a position of significant influence, given the dual nature of the CRAs registration.

6.5.3 Organisational requirements (confidentiality)

159. **With regards to whether there is a specific definition of inside information**, a definition of "relevant information" is set out in Section 245 of the SFO. In addition, the Hong Kong supervisor has confirmed that if any information relating to credit ratings and rating outlooks falls under this definition, it is considered as inside information.

160. **With regards to whether the definition of inside information is extended to credit ratings, rating outlooks and information thereto,** there is no explicit provision which automatically deems credit ratings, rating outlooks and information related thereto as inside information, though they may be judged as such if they fall within the said definition under Section 245 of the SFO.

161. **With regards to the internal procedures a CRA is required to put in place,** detailed requirements are set out in Paragraphs 60, 63, 64, 65 and 67 of the CoC. In this regard Paragraph 60 requires CRAs to adopt procedures and mechanisms to protect the confidential nature of information shared with it by a rated entity. Paragraph 63 requires a CRA to prohibit its representatives and employees from engaging in transactions in securities when they possess confidential information concerning the issuer of such securities. Paragraph 64 requires representatives and employees of the CRA to familiarise themselves with the internal securities trading policies maintained by the CRA and periodically certify their compliance with these. Paragraph 65 sets out requirements to ensure that the representatives and employees of the CRA do not selectively disclose any non-public information about ratings, or the possible future issue or revision of ratings, except to the rated entity or its designated agents. Paragraph 67 specifies that a CRA should ensure that its representatives and employees do not use or share confidential information for the purpose of trading securities or for any other purpose except carrying out Type 10 regulated activity (preparation of credit ratings).

Confidentiality

The Hong Kong regime sets out detailed requirements regarding the steps CRAs must take to protect the confidential information relating to issuers. There is also a credible legislative regime in place protecting against the misuse of inside information. However, it also clear that the Hong Kong regime does not consider credit ratings, rating outlooks and information related thereto to automatically be considered as inside information.

6.5.4 Quality of methodologies and of credit ratings (Quality of credit ratings and analysis of information used in assigning credit ratings)

162. With regards to whether there is a requirement for a credit rating agency to submit a rating to a rated entity for review prior to its publication, there is no strict requirement to do so under the Hong Kong regime. Instead, Paragraph 56 of the CoC requires that CRAs where "feasible and appropriate" inform the rated entity of the critical information and principal considerations upon which a rating will be based. The timeframe to be provided to the rated entity is not specified however there is a supervisory understanding that this time period should be reasonable.

Quality of credit ratings and analysis of information used in assigning credit ratings

The approach of the Hong Kong framework is different to that of the EU in so far as it places a higher priority on the rating being communicated to the market without any possible delay. As a result there is no strict requirement for a CRA to inform a rated entity about a credit rating prior to its publication. Instead, a CRA should only notify a rated entity when "feasible and appropriate".

6.5.5 Quality of methodologies and of credit ratings (Quality of methodologies and changes to them)

163. **With regard to the requirement that credit ratings are issued in accordance with the published methodologies,** Paragraph 4 of the CoC requires CRAs to adopt written procedures to ensure its credit ratings are elaborated according to the CRA's published methodologies. In addition, Paragraph 49 of the CoC requires that for each rating announcement a CRA should indicate the principal methodology that was used in determining the rating, including where a description of that methodology can be found. In addition, Paragraph 50 of the CoC requires the CRA to publish sufficient clear and easily comprehensible information about its procedures methodologies and assumptions, in order to enable other parties to understand how a rating was determined. In practice, the Hong Kong regime expects that credit ratings are prepared based on published methodologies.

164. **With regard to the obligation to correct, publish and report errors in methodologies to the supervisor** Paragraph 9 of the CoC requires CRAs to take steps

to avoid issuing any credit ratings that contain misrepresentations or are otherwise misleading as to the general creditworthiness of the rating target. While there is no specific requirement for CRAs to disclose errors identified in the rating methodologies, Paragraph 59 of the CoC requires that a CRA fully and publicly discloses any material modification to its methodologies. In addition, it further requires that where feasible and appropriate the CRA should disclose such material modifications prior to their going into effect. Should there be any change to methodologies, models or key rating assumptions used in preparing any of its credit ratings, the CRA is required to immediately disclose the likely scope of credit ratings to be affected using the same means of communication as was used for the distribution of the affected credit ratings.

165. **With regard to the obligation to consult market participants on material changes to methodologies and publish the responses,** In addition, Paragraph 12 of the CoC requires CRAs to establish and implement a rigorous and formal review function responsible for periodically (and at least annually) reviewing the methodologies and models and significant changes to the methodologies and models, it uses, and (b) the adequacy and effectiveness of the CRAs systems and internal control mechanisms. Paragraph 16 of the CoC requires that where a methodology or model is changed as a result of the internal review process, the CRA should review the affected ratings as soon as possible and not later than six months after the change, placing the ratings under observation until the change is made.

Quality of methodologies and changes to them

There are some differences between the Hong Kong and the EU regime. However, the requirements that credit ratings are only issued in accordance with published methodologies, that methodologies are reviewed on a periodic basis and that CRAs disclose the likely scope of all credit ratings affected, are all present.

6.5.6 Disclosure (Presentation and disclosure of credit ratings)

166. **With regard to the obligations to accompany the disclosure of a methodology underpinning an individual credit rating with guidance**, Paragraph 49 of the CoC requires that with each rating announcement a CRA should indicate the principal methodology or methodology version that was used in determining the rating and where a description of that methodology can be found. In addition, Paragraph 50 of the CoC requires that a CRA should ensure that sufficient clear and easily comprehensible information should be published about its procedures methodologies and assumptions to enable parties to understand how a rating was determined.

167. **With regard to the prohibition from including irrelevant elements in the presentation of credit ratings and rating outlooks and the obligation to stipulate that the rating is the agency's opinion and should be relied upon to a limited degree**, Paragraph 9 of the CoC states that a CRA should take steps to avoid issuing any credit ratings that contain misrepresentations as to the general creditworthiness of

a rating target. In addition, Paragraph 28 states that the determination of a credit rating should be influenced only by factors relevant to the credit assessment.

168. **With regard to the requirement to indicate whether the rated entity or related third party participated in the credit rating process using a clearly distinguished colour code when issuing an unsolicited rating**, there is no requirement for a colour code under the Hong Kong regime, However Paragraph 58 of the CoC requires a CRA to state prominently whether or not the rated entity participated in the credit rating process. In addition, this paragraph of the CoC requires a CRA to disclose its policies and procedures regarding unsolicited ratings.

169. **With regards to whether there is a requirement to disclose on an annual basis details regarding the CRAs revenue**, while there is no requirement to issue a public report containing this information, as a licensed corporation, Section 156 of the SFO requires a CRA to submit its annual audited accounts and other required documents to the SFC within four months after its financial year end. In addition, Section 56(3) of the Securities and FFR requires a CRA to submit semi-annual returns. In such semi-annual returns, CRAs are required to report the aggregate income arising from the provision of credit rating services during the reporting period, as well as the number of active clients as at the end of the reporting period.

Presentation and disclosure of credit ratings

There are some differences between the Hong Kong and EU regime. Most notably, the requirements for annual public disclosure of revenues of the CRA or a colour code indicating the participation of the issuer, which are not present.

However, there Hong Kong regime does have requirements to ensure that credit ratings are accompanied with sufficient guidance to enable users of ratings to understand them. In addition, there are also requirements to ensure that credit ratings are only concerned with factors relevant to an analysis of the issuer's creditworthiness. Finally, there is also a requirement to provide the supervisor with annual, and semi-annual, information regarding its business activities.

6.5.7 Disclosures (Periodic disclosure about the CRA and competition)

170. With regards to whether there is a requirement for CRAs to disclose on their website and to the SFC on an ongoing basis, information about all entities or debt instruments submitted to it for their initial review or preliminary rating, there is no similar requirement in the Hong Kong regime. By way of compensation, Paragraph 6 of the CoC requires CRAs to keep business records in line with all statutory requirements for a period of seven years. Under section 3 of the Securities and Futures (Keeping of Records) Rules, CRAs are required to keep records as are sufficient to explain the operation of the business which constitutes a regulated activity. In conjunction with this record keeping requirement, the SFC is empowered by Sections 180 or 183 of the SFO to request CRAs

and/or other relevant persons as set out in the provisions to furnish information for the purpose of (i) ascertaining whether the person is complying or has complied with the applicable rules and regulations or (ii) conducting investigation.

171. **With regards to the information a CRA is required to provide to the SFC regarding its pricing policies**, under the Hong Kong regime there is no direct ongoing obligation for CRAs to provide the SFC with information regarding its pricing policies or actual fees charged for an individual rating. However, Paragraph 34 of the CoC requires CRAs to publicly disclose the general nature of its compensation arrangements with rated entities. In addition, in the semi-annual returns required to be submitted by CRAs under the FRR, CRAs are required to report the aggregate income arising from the provision of credit rating services during the reporting period. Under section 57 of the FRR, the SFC is empowered to request CRAs to provide information, including any record or document as the SFC may specify, relating to the financial resources of the CRAs. Furthermore, the SFC may, in appropriate cases, exercise its powers under Sections 180 or 183 of the SFO to request such additional information from a CRAs.

172. **Regarding whether there are any requirements in place to ensure that fees charged to clients are non-discriminatory and based on actual costs**, there is no direct equivalent in the Hong Kong regime. However, Paragraph 2.2 of the General Code specifies that in "the general course of dealing or advising concerning a client…. fees affecting a client should be fair and reasonable in the circumstances, and characterised by good faith".

Competition and general periodic disclosures

With regards to disclosures in respect of preliminary ratings, the Hong Kong regime has no similar requirements to those of the EU regime. With regards to disclosures of pricing policies to the supervisor and the market, there are also no explicit requirements under the Hong Kong regime, although there are some disclosure requirements regarding revenues obtained from major clients and the supervisor is empowered to request this information. Regarding the measures to protect clients and ensure they are fairly treated, there is a general requirement that clients should be treated fairly.

Conclusion

On the basis of this assessment ESMA concludes that the Hong Kong legal and supervisory framework is meeting the objectives of the additional CRA 3 regulatory requirements.

6.6 Japan

173. This section of the report explains how ESMA assesses equivalence of the legislative and supervisory framework of Japan with the additional equivalence requirements introduced by the CRA 3 Regulation. The approach adopted has focused on the new provisions of the additional equivalence requirements, identifying the importance of any differences.

174. As such, this analysis should be read in conjunction with the 2010 Technical Advice[24] on regulatory equivalence[25] which assessed the Japanese regulatory and supervisory framework against the broader requirements of CRA 1 Regulation, as well as the methodological framework in Annex III.

175. In this regard, the following are the legislative and supervisory provisions that were assessed:

- Cabinet Office Ordinance on Financial Instruments Business;
- Financial Instruments and Exchange Act;
- Guidelines for Supervision of Credit Rating Agencies.

6.6.1 Scope of the regulatory and supervisory framework (Rating Outlooks)

176. **As regards the approach adopted to regulating rating outlooks**, the supervisory and regulatory framework in Japan, in substance, recognises rating outlooks like a number of jurisdictions, since it considers a rating outlook to be part of the credit rating to which it is related. As a result, the relevant definition applicable to both credit ratings and rating outlooks is "Credit Rating" as set out in Article 2(34) of the FIEA. Under this definition a credit rating is understood as:

"…a grade which indicates, through symbols or figures (including anything specified by Cabinet Office Ordinance as being similar thereto), the results of an assessment of the credit status of a Financial Instrument or a corporation (including anything specified by Cabinet Office Ordinance as being similar thereto) (such assessment is hereinafter referred to as "Creditworthiness" in this paragraph) (such grade excludes grades specified by Cabinet Office Ordinance as being determined mainly in consideration of any particular other than Creditworthiness)."

177. ESMA has been informed by the JFSA that rating outlooks are substantively recognised within the legal framework, CRAs are permitted to provide a definition of outlooks as part

[24] CESR/10- 333 Technical Advice to the European Commission on the Equivalence between the Japanese Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies, available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/10_333.pdf

[25] https://www.esma.europa.eu/sites/default/files/library/2015/11/10_333.pdf

of their internal credit ratings policy. The allowance for this inclusion in the credit rating policy illustrates how rating outlooks are seen as a contingent part of a credit rating, and as a result, required to adhere to all of the same requirements applicable to credit ratings with which the rating policy is concerned.

178. From a practical perspective, ESMA has also been informed that JFSA supervisory monitoring addresses the appropriateness of rating outlooks in conjunction with their associated credit ratings on both a regular and ad-hoc basis.

Outlooks

In light of the above, two determinations can be made. The first is that the Japanese framework is not identical to the EU framework given that it does not explicitly recognise rating outlooks as a separate and distinct item from a credit rating. The second is that functionally the Japanese framework results in the same objectives in practice concerning the effective supervision of credit rating activities and the consequences for investor protection.

6.6.2 Conflicts of interest management

179. In assessing the measures a CRA is required to have in place to prevent and mitigate against conflicts of interest the relevant legislative provisions are Articles 66-33 of the FIEA, Article 306 of the COOFIB, and sections III-2-1 and III-2-2 of the Guidelines for Supervision of CRAs.

180. **As regards the effective internal control structures,** Article 66-33 of the FIEA requires a CRA to establish an operational control system for the fair and appropriate performance of its Credit Rating Services. This operational control system must include measures for preventing the investor's interests being harmed with the aim of benefitting the Credit Rating Agency. The specific requirements of an operational control system are set out in Article 306 (1)(vii) of the COOFIB where it is specified that the operational control system must prescribe measures to address conflicts of interest across a wide area of the CRAs activities. The specific requirements of Article 306 of the COOFIB are explained in further detail through the Sections III-2-1 and III-2-2 of the Guidelines for the Supervision of Credit Rating Agencies. Taken together the Japanese legal and supervisory framework has a clear and comprehensive approach to the requirement for a CRA to put in place a robust internal control framework.

181. **As regards conflicts of interests relating to shareholders**, Article 306 of the COOFIB includes a detailed list of requirements that a CRA's conflict of interest policies must address. Although there is no specific requirement that these policies include measures to address "shareholders" in a general sense there are a number of alternative requirements that could be seen as achieving the same result. These requirements include a general provision that a CRA must put in place measures to ensure that the CRA does not harm the interests of investors in the process of determining a credit rating.

In addition, there is a more specific requirement for the CRA to put in place measures to ensure that the CRA does not harm the interest of investors where a shareholder of more than 5% of the CRA is rated by that CRA.

182. **With regards to the specific ownership thresholds of 10% and 5%,** With the exception of the above requirement, the fixed thresholds for shareholdings provided for in the CRA 3 are not reflected within the Japanese framework. In accordance with Article 66-35 of the FIEA it is prohibited for a CRA to issue a credit rating if the CRA or its officer or employee meet the definition of person closely associated with a rating as set out in Article 308 of the COOFIB. This includes the scenario where the person closely associated with a rating holds securities in the rating subject. To summarise, according to Article 306 of COOFIB a CRA needs to put in place measures to prevent against conflicts of interest in situations where a rated entity has a 5% or more shareholding in the CRA. However, the CRA is prohibited from carrying out a rating altogether if the CRA has an interest in the rated entity.

Conflicts of Interest Management

Overall the Japanese framework is significantly more detailed than the EU regime with regards to the steps a CRA needs to take to prevent or mitigate any conflicts of interest. This is as a result of the interaction of three pieces of legislation, the FIEA, COOFIB and Guidelines on Supervision. The end result, is that CRAs are required to have detailed and comprehensive internal control structures in place to mitigate against conflicts of interest.

However, the regulatory framework does have some notable difference with the EU regime in respect of its treatment of shareholders of both the CRA and rated entities. The regime is very strict on the CRA issuing a rating on entities in which the CRA or any of its officers or employees have a financial interest. This is prohibited. However, a CRA is only required to take account of potential conflicts of interest in relation to ratings issued on its own shareholders in cases of shareholding of 5% or more. In which case it must ensure the interests of investors are not harmed.

6.6.3 Organisational requirements (confidentiality)

183. **With regards to whether there is a specific definition of inside information**, a definition for inside information is set out in Article 1(4) (xiv) of the COOFIB. This definition is provided as “Corporate Information” which means any information on the operation, business or properties of Listed Companies which is found to have an impact on customers investment decisions.

184. **With regards whether the definition of inside information is extended to credit ratings, rating outlooks and information thereto**, there is no explicit provision which automatically deems credit ratings, rating outlooks and information related thereto as inside information. The approach of the Japanese framework is to deem any information

which meets the aforementioned qualitative standards (set out in the previous section) as inside information, rather than providing a list of specific categories of information that fall under the scope of inside information. ESMA has been informed by the JFSA that information related to credit ratings would be deemed to meet the test of inside information. Furthermore, Article 306 (1)(xii) of the COOFIB imposes broad requirements that CRAs must implement measures to properly manage information they obtain in the course of rating business and appropriately maintain confidentiality. In this respect, the requirements for CRAs can be considered quite stringent given that they must maintain confidentiality regardless of whether a piece of information meets the test of inside information or not. Similar to the EU regime, as a means of proper information management, Article 306 (1)(xii)(b) of the COOFIB requires CRAs to identify the scope of persons who are in a position to obtain confidential information.

185. **With regards to the internal procedures a CRA is required to put in place,** Articles 66-33 (1) a CRA must establish an internal control system for the fair and appropriate performance of its credit rating services. This must include measures to prevent investors' interests being harmed for the benefit of the CRA. Article 306 (1) (xii) of the COOFIB sets out the measures that a CRA's business management system must have in place in order to properly manage information which may come to its attention in the course of the performance of the Credit Rating Business. This should include measures to ensure that any information or secrecy that comes to the attention of the CRA in the course of its business is not used for any other purpose than deemed necessary for the Credit Rating Business. In addition the business management system must contain measures to prevent the leakage of secret information by identifying the scope of such secret information, including who has access as well as methods for managing secrecy procedures.

Confidentiality

The Japanese regime sets out detailed requirements regarding the steps CRAs must take to protect the confidential information relating to issuers. There is also a credible regime in place protecting against the misuse of inside information. However, it is also clear that the Japanese regime does not have a provision that automatically deems credit ratings, rating outlooks and information related thereto as inside information.

6.6.4 Quality of methodologies and of credit ratings (Quality of credit ratings and analysis of information used in assigning credit ratings)

186. **With regards to whether there is a requirement for a credit rating agency to submit a rating to a rated entity for review prior to its publication**, Article 66-35 of the FIEA requires CRAs to establish a rating policy that establishes the methodology for determining and disclosing its credit ratings. Further detail on what should be covered in this Rating Policy is set out in Article 313 (2) (iv) of the COOFIB which requires that the rating policy provides guidelines and methods to enable a person subject to rating to verify whether there is any factual misrepresentation in a credit rating prior to its

publication. Section III-2-3 (1)(v) of the Guidelines for Supervision of CRAs requires the policies put in place by the CRA allow the rated entity a "reasonable amount of time" to express his/her opinions on the credit rating.

Quality of credit ratings and analysis of information used in assigning credit ratings
The Japanese framework is different to that of the EU wherein there is a principles based approach to the amount of time that a rated entity should be provided. In this regard the EU regime requires "a full working day" whereas the Japanese requirement is for "a reasonable amount of time".

6.6.5 Quality of methodologies and of credit ratings (Quality of methodologies and changes to them)

187. **With regard to the requirement that credit rating changes are issued in accordance with the published methodologies,** Article 314 of the COOFIB sets out requirements for a CRAs rating policy to consider with regards to the announcement of the rating policy. All credit ratings issued by the CRA must be issued according to this rating policy, as such it could be understood that all credit ratings must be published in accordance with an existing methodology.

188. **With regard to the obligation to consult market participants on material changes to methodologies and publish the responses***,* Article 314 (3) of the COOFIB sets out:

In cases where a Credit Rating Agency intends to effect any material change to its Rating Policy, etc., it is to, in advance, announce the fact that the change will be effected and an outline of such change; provided, however, that if any unavoidable ground exists, such unavoidable ground, the fact of the change and an outline thereof may be announced without delay after the change.

189. The JFSA has outlined to ESMA that CRAs are required to conduct public consultations for proposed material changes through their websites in order to examine appropriateness of the proposed changes, as well as analyse potential impact on their existing rating determination policies and methods by section III-2-1(5)(iv)(v) of the Guidelines for Supervision of Credit Rating Agencies. In addition, under the Japanese regime, the JFSA requires CRAs to submit the periodic compliance report on a quarterly basis that comprehensively cover a wide range of areas, such as internal controls, compliance, quality controls, conflict of interests, confidentiality, business activities and so on. This report requires detailed information related to methodology changes, together with ensuring public consultation process are adequately conducted for the proposed changes. In addition, the JFSA has explained that the requirement of "advance announcement" in the Japanese regime should be understood as meaning "public consultation", and also confirmed that CRAs have conducted prior public consultations whenever a "material change" has been made to their methodology. This is also

explained by the fact that there is a difference between requirements for “changes” and “material changes”. “Changes” are subject to a “public disclosure” as set out in Article 66-36(1) of the FIEA, as opposed to “advance announcement” (i.e. public consultation) required for “material changes”.

190. With regards to whether there is a requirement to inform the supervisor and all rated entities affected by a change to a methodology, Article 66-36 of the FIEA requires a CRA to publicly disclose a change, not only to notify the supervisor and affected entities. Although there is no mention in Article 313 of the COOFIB as to what specific notification procedures vis-a-vis its supervisor or the affected rated entities a CRA should put in place as a result of a change to a methodology, Article 66-32 of the FIEA sets out an overarching duty of sincerity to the clients of the CRA which could be construed as a legal obligation to ensure that affected entities are appropriately informed.

191. **With regard to the obligation to correct, publish and report errors in methodologies to the supervisor** Article 313 of the COOFIB sets out the requirements for a CRAs rating policy. The rating policy determines the methodologies underlying the credit ratings as well as the measures for their disclosure. Article 313 (2) of the COOFIB requires that the Rating Determination Policy (which is a sub-section of the Rating Policy) satisfies requirements that it is rigorous and systematic. Article 306 (1) (vi) (b) of the COOFIB requires that the CRA put in place measures to ensure that the information used in determining a Credit Rating is of sufficient quality. Article 66-33 (1) of the FIEA requires that the operational control system established by the CRA should ensure the fair and appropriate performance of its Credit Rating Services. This provision could therefore be read in conjunction with the previously mentioned Article 313 (2) of the COOFIB which required CRAs methodologies to be rigorous and systematic, as well as Article 66-32 of the FIEA sets out an overarching duty of sincerity to the clients of the CRA.

Quality of methodologies and changes to them

The approach of the Japanese framework with regards to ensuring the ongoing quality of a CRAs methodologies is to require the CRA to put in place a rating policy that adheres to a number of high level principles established in Law. To a large degree these principles cover the same areas as the EU regime, however they lack the specificity as to the precise actions a CRA must take in areas such as reporting to the supervisor or affected rated entities.

6.6.6 Disclosure (Presentation and disclosure of credit ratings)

192. **With regard to the obligations to accompany the disclosure of a methodology underpinning an individual credit rating with guidance**, Article 66-36 (1) and (2) of the FIEA requires CRAs to put in place a rating policy for determining and disclosing credit ratings and for Credit Rating Services to be carried out in accordance with the policy. Further to this Article 313 (2) (iii) (a) of the COOFIB requires that as part of the

disclosure of a credit rating, the credit rating includes criteria used for identifying matters which serve as assumptions for the assessment of the credit status as well as an outline of the method for determining the rating. As part of this disclosure the CRA should, in accordance with Article 313 (3)(iii)(i) of the COOFIB provide an explanation on the assumptions, significance and limitations of the credit rating, including "an explanation on the characteristics of the fluctuation of Credit Ratings; and also including an explanation on the limits of the Credit Rating, in cases where the object of the Credit Rating is the assessment of the credit status of the financial instruments with limited information on the transition of the credit status".

193. With regard to the prohibition of irrelevant elements in the presentation of credit ratings and rating outlooks and the obligation to stipulate that the rating is the agency's opinion and should be relied upon to a limited degree, the CRA 3 requirement that credit ratings shall not present factors other than those related to the credit rating is not directly replicated in the Japanese framework. However, Article 306 (1) (xv) of the COOFIB requires CRAs to implement measures to prevent any false or misleading representation. Article 313 (3)(v) of the COOFIB also specifically prohibits misrepresentation that appropriateness of credit assessment has been guaranteed by the JFSA or any other administrative organs. Furthermore, the principle could also be seen as being replicated via Section III-2-3(1)(i) which requires CRAs to maintain the appropriateness of disclosures to stakeholders.

194. **With regard to the requirement to indicate whether the rated entity or related third party participated in the credit rating process using a clearly distinguishable different colour code for the rating category**, there is no such requirement to include a colour code indicating whether the rated entity participated in the rating process under the Japanese framework.

195. **With regards to whether there is a requirement to disclose on an annual basis details regarding the CRAs revenue,** Article 66-39 of the FIEA requires a CRA to create a document called "explanatory document" on an annual basis and make it available on its website. As set out in Article 308 of the COOFIB, the "explanatory document" must include major information such as outline of business, total revenue, fee structure, name of the clients who paid 10% or more of the total revenue, top 10 shareholders etc. as well as status of ancillary services. Separately, Article 66-38 of the FIEA requires that each business year a CRA should prepare and submit a business report to the Prime Minister. This business report should be prepared in accordance with Appended Form No.28 which requires a CRA to report information regarding its business activities for that fiscal year and should include the total number of credit ratings provided by the CRA and the top 20 client's names and fees paid during that year. In addition the Business Report should provide details of ancillary services provided by the CRA.

Presentation and disclosure of credit ratings

There are some differences between the Japanese and EU regime. However, the Japanese regime does have requirements to ensure that credit ratings are accompanied

with sufficient guidance to enable users of ratings to understand them. In addition, there are also requirements to ensure that CRAs maintain the appropriateness of their disclosures to stakeholders. There is also a requirement for annual public disclosure of revenues. Finally, there is a requirement to provide the supervisor with annual information regarding its business activities, although the information on revenue is limited to the top 20 clients.

6.6.7 Disclosure (Periodic disclosure about the CRA and competition)

196. **With regards to whether there is a requirement for CRAs to disclose on their website and to the JFSA on an ongoing basis**, information about all entities or debt instruments submitted to it for their initial review or preliminary rating, Under the Japanese regime , the JFSA has informed ESMA that it requires CRAs to submit the periodic compliance reports on a quarterly basis covering a wide range of areas, such as internal controls, compliance, quality controls, conflict of interests, confidentiality, business activities and so on. These reports are required to include detailed information related to rating shopping, including whether an issuer withdraws a credit rating request during its rating process or before its credit rating is released, in order to limit potential rating shopping through the supervisory monitoring process. In addition, provisions, such as Article 306 (1) (i) of the COOFIB which requires the business management system of the CRA to put in place measures to "always maintain a fair and unbiased stance in order to perform its Credit Rating Activities…". An additional safeguard is provided by Article 306 1 (vii) (a) of the COOFIB which requires the business management system to include measures to identify Credit Rating Activities which entail any actual or potential Conflicts of Interests to ensure such acts do not adversely affect the interests of investors.

197. **With regards to the information a CRA is required to provide to the JFSA regarding its pricing policies and the specific fees charged to clients of the CRA**, Article 66-38 of the FIEA requires that each business year a CRA prepares a business report and submits it to the JFSA. This information must be submitted in accordance with Article 316 (1) of the COOFIB and Appended Form No.28 and must contain the top 20 clients' names and the fees paid by each of them during the fiscal year. There is however no similar requirement to the EU regime for the CRA to provide to the supervisor data on fees charged to individual clients, although the JFSA is empowered to request relevant information in accordance with Article 66-45 (1) of the FIEA wherever it is deemed necessary.

198. **With regards to whether there are any measures in place to ensure that fees charged by the CRA are non-discriminatory and cost based**, under the Japanese regime, there are similar provisions to ensure that clients are fairly treated are provided. For example, Article 66-33 (1) of the FIEA requires a CRA to establish an operational control system for the fair and appropriate performance of its Credit Rating Services. In addition Article 306 (1) (x) of the COOFIB which specifies the required measures a CRAs business management system must include requires that a CRA put in place measures to formulate the policy for determining remuneration of the officers or employees of the

CRA in such a way as to ensure they do not adversely affect the performance of the Credit Rating Business from being performed in a fair and accurate manner. Additionally, Article 306 (1)(b)(xi) of the COOFIB requires the business management system to have in place measures to prevent persons in charge of ratings from participating in the negotiation process for determining the rating for the credit rating.

Competition and general periodic disclosures

With regards to disclosures in respect of preliminary ratings, the Japanese regime has no similar requirements to those of the EU regime as these concepts are not recognised under the Japanese regime. With regards to disclosures of pricing policies to the supervisor and the market, CRAs are required to provide the details for their top 20 clients. With regards to protections for the clients of CRAs that the fees they are charged are cost based and non-discriminatory, the Japanese regime contains requirements to ensure CRAs to perform their business in a fair and accurate manner.

Conclusion

On the basis of this assessment ESMA concludes that the Japanese legal and supervisory framework includes sufficient provisions to meet the objectives of the additional CRA 3 regulatory requirements.

6.7 Mexico

199. This section of the report explains how ESMA assesses equivalence of the legislative and supervisory framework of Mexico with the additional equivalence requirements introduced by the CRA 3 Regulation. The approach adopted has focused on the new provisions of the additional equivalence requirements, identifying the importance of any differences. Since the technical assessment performed in May 2013, the relevant Mexican legal framework in relation to credit rating agencies was amended[26] in July 2014 was amended to introduced, among other, provisions to avoid conflict of interest between CRAs and states/municipalities.

200. As such, this analysis should be read in conjunction with the 2013 Technical Advice on regulatory equivalence [27] which assessed the Mexican regulatory and supervisory framework against the broader requirements of CRA 1 Regulation, as well as the methodological framework included in Annex III.

201. The following key to references, terms and legislative and supervisory provisions used in this advice:

- CNBV: Comisión Nacional Bancaria y de Valores.
- MCRAR: Mexican credit rating agencies rules (Disposiciones de carácter general aplicables a las instituciones calificadoras de valores published on 17 February 2012).
- Annex I of MCRAR: contains the minimum guidelines to be developed into the CRAs' code of conducts.
- SML: Securities Market Law, Title IX, Chapter II (Ley de Mercado del Valores).

6.7.1 Scope of the regulatory and supervisory framework (Rating Outlooks)

202. **As regards ensuring that rating outlooks are accurate, transparent and free from conflicts of interest**, the supervisory and regulatory framework in Mexico does not explicitly recognise rating outlooks in the same way as the EU framework. The reason for this is that the approach taken by the Mexican framework is to set out a general set of services that a CRA is registered to perform. As a result the Mexican framework does not have separate definitions for "credit ratings" or "rating outlooks". In this regard, Article 334 of the SML sets out the CRAs are registered to perform the customary and professional rendering of services such as research, analysis, opinion, evaluation and

[26] http://www.dof.gob.mx/nota_detalle.php?codigo=5351727&fecha=09/07/2014
[27] ESMA/2013/626 Technical advice on CRA regulatory equivalence – on Argentina, Brazil, Mexico, Hong Kong and Singapore, Available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-626_esma_technical_advice_on_equivalence_of_argentina_brazil_mexico_hong_kong_singapore_with_eu_on_cras_supervision_30_may_2013.pdf

issuance of a report on the credit qualifications of securities. According to this, CNBV understands that rating outlooks are one of the services for which a CRAs is registered to perform.

203. From a supervisory perspective, ESMA has been informed by CNBV that it expects the production of rating outlooks to adhere to all of the same requirements as the credit ratings of which they are considered. As a result, the rating outlook has to be produced with the same transparency, independence and disclosure requirements. Furthermore, CNBV includes in their supervisory monitoring the appropriateness of rating outlooks in conjunction with their associated credit ratings.

Outlooks

In light of the above, two determinations can be made. The first is that the Mexican framework is not identical to the EU framework given that it does not explicitly recognise rating outlooks as a separate and distinct item from a credit rating. The second is that functionally the Mexican framework results in similar objectives in practice concerning the effective supervision of credit rating activities and the consequences for investor protection.

6.7.2 Conflicts of interest management

204. **As regards the effective internal control structures,** Second provision, section III, subsection d), number 4 of MCRAR requires CRAs to establish internal manuals containing, amongst others, internal control mechanism and procedures which should contain the identification and removal of any conflict of interest that could influence the ratings provided or any other activities performed in accordance with the corporate purpose. Annex I, section IV, subsection B) of MCRAR additionally requires that conflict of interest as well as their management have to be informed to the person or responsible area for monitoring compliance with the applicable legislation.

205. **As regards conflicts of interests relating to shareholders**, the SML and MCRAR requires CRAs to establish policies, procedures and mechanisms to ensure that issuance of credit ratings are free from conflict of interest. In relation to shareholders, Article 337 of SML states that shareholders, members of the board of directors, general directors, examiners and the executive directors of the CRA cannot hold, directly or indirectly, any shares of financial rated entities. Furthermore, they cannot act as or have the capacity of shareholders, general directors, or executive directors of the rated entities. Annex I, section IV, subsection K) of MCRAR additionally requires CRAs to establish mechanisms to ensure that investments in securities and structured financial instruments of shareholders, board members, general directors, executive directors, commissioners and technical staff responsible for preparing opinions and monitoring credit ratings do not generate conflict of interest.

206. Besides, Article 338 of the SML establishes that CRAs may not celebrate any type of contracts with respect to securities issued by companies with whom their shareholders, directors or executive officers involved in the credit rating process of such securities, have a conflict of interest.

207. **With regards to the specific ownership thresholds of 10% and 5%,** the fixed thresholds for shareholdings provided for in the CRA 3 are not reflected within the Mexican framework. However, as indicated above, there is a general prohibition for shareholders and board members to hold, directly or indirectly, any share of the financial rated entity. Additionally, MCRAR Fifth provision, last paragraph states that in the event that a client holds a stake in the CRA's capital, the latter must refrain from providing any of its services, unless such participation is less than 5% of the total CRA's capital.

Conflicts of Interest Management
Similar to the EU regime, the Mexican legal framework requires a CRA to establish adequate and effective internal organisational mechanism and procedures to prevent, detect, and remove any conflict of interest. The Mexican regime also includes a general prohibition for shareholders and board members to hold, directly or indirectly, any share of the rated entity. Additionally, CRAs cannot provide any service to clients with more than 5% of their capital..

6.7.3 Organisational requirements (confidentiality)

208. **With regards to whether there is a specific definition of inside information**, Article 362 of the SML defines insider information ("privileged information") as "any knowledge of relevant events that have not been disclosed to the public by the issuer through the stock exchange where its shares are traded".

209. **With regards whether the definition of inside information is extended to credit ratings, rating outlooks and information thereto,** there is no explicit provision which automatically deems credit ratings, rating outlooks and information related thereto as inside information under the Mexican regime, though they may be judged as such if they meet the standards of the definition.

210. **With regards to the internal procedures a CRA is required to put in place,** , Second Provision, section III, subsection c) and Annex I, section III, subsections A, and B of the MCRAR requires a CRA to have internal manuals containing policies setting out the management of client information. These policies should provide for at least the following (i) the authorised staff to receive relevant information from clients (ii) procedures to classify and protect relevant information received from clients (iii) adequate safety measures to protect clients records in possession of the CRA from theft or misuse.

211. In addition, the executive and technical staff of the CRA must refrain from disclosing relevant information about ratings or modifications which have not been made public.

Confidentiality

The Mexico regime sets out detailed requirements regarding the steps CRAs must take to protect the confidential information relating to issuers. There is also a credible legislative regime in place protecting against the misuse of inside information. However, it also clear that the Mexican regime does not consider credit ratings, rating outlooks and information related thereto to automatically be considered as inside information.

6.7.4 Quality of methodologies and of credit ratings (Quality of credit ratings and analysis of information used in assigning credit ratings)

212. **With regards to whether there is a requirement for a credit rating agency to submit a rating to a rated entity for review prior to its publication**, Section V of the Fifth Provision of MCRAR states that CRAs have to include in their contracts of services with their clients, among others, the obligation for the CRA to inform the rated entity with all relevant information, as well as major considerations used for the determination of the credit rating in advance of its publication. The rated entity can review the relevant information and, where appropriate, request to not disclose confidential information. The Mexican legal framework does not specify the time to be provided to the rated entity to provide comments and leaves to the parties to agree on the minimum period of time for the review. The legal framework also foresees that the parties agree on the CRA issuing the credit rating without giving prior notice to the client.

213. ESMA has been informed by the CNBV that the normal practice in the credit rating market is to provide to the rated entity at least a full business day before publication for providing comments on its rating.

Quality of credit ratings and analysis of information used in assigning credit ratings

There is a requirement for a CRA to inform a rated entity about a credit rating prior to its publication. However, unlike the EU regime, the Mexican regime allows the CRA and the rated entity to agree on whether or not the CRA has to provide prior notice to the client and if so, the period of time for providing comments. The Mexican legal framework has taken a slight different approach than the EU legal framework. The rated entities are provided with the option to review their credit ratings prior to publication.

6.7.5 Quality of methodologies and of credit ratings (Quality of methodologies and changes to them)

214. **With regard to the requirement that credit rating changes are issued in accordance with the published methodologies,** Annex I, section V, subsection A), number 10 of the MCRAR requires CRAs to disclose in the press release the relevant elements related to the rating such as the methodology used to grant or modify the qualification, indicating its version and date of approval, as well as the indication of the place where it can be

consulted. In the event that a rating is based on more than one methodology, this fact should be noted, and include an explanation of how the different methodologies and elements involved in the rating decision were taken into account. The last paragraph of the Eight provision of MCRAR requires CRAs to publish on its website methodologies and procedures used for the research, analysis, opinion, evaluation and consideration on credit quality, before they are used, and must disclose any material change to their methodologies, so they can be consulted by the investing public. Taking into account these Articles, it could be understood that all credit ratings must be published in accordance with an existing methodology.

215. **With regard to the obligation to consult market participants on material changes to methodologies and publish the responses**, there is no requirement for a CRA to conduct a consultation with market participants prior to a change in their methodology. The CRA is required to notify to CNBV regarding the amendments introduced into the rating methodology (Article 335 of SML) and publicly disclose in their websites any material changes to their methodologies (Eight provision of MCRAR). While it is positive that CRAs are required to inform CNBV and announce a material change to their methodology this is a divergence from the EU Regime, there is no explicit requirement for CRAs to conduct a consultation with market participants prior to making a change. As a result there is also no requirement to publish the responses to a consultation.

216. **With regard to the obligation to correct, publish and report errors in methodologies to the supervisor**, the Mexican legal framework does not explicitly require CRAs to address errors identified in their methodologies. However, as indicated above, there is a requirement for CRAs to review their methodologies and models. In case the CRA introduces significant changes to the rating methodologies, the CRAs have to inform CNBV and disclose them to the public although there is no requirement to disclose the reason why the methodology has been changed (for example, due to an identified error).

217. With regards to requirements to notify affected rated entities, the Mexican legal framework establishes that in case there is an amendment to the CRAs' rating models and methodologies, the CRA has to review all ratings previously issued (Annex I, section II, subsection A), number 4 of the MCRAR).

Quality of methodologies and changes to them

There are some notable differences between the Mexican regime and the EU regime, most notably in the requirement for a CRA to consult on changes to its methodologies, disclose and communicate errors and systematically review methodologies when an error is identified. This being said the principal requirements that; credit ratings are only issued in accordance with published methodologies, methodologies are reviewed on a periodic basis and affected rated entities are informed are all present. In order to fulfil objectives equivalent to the EU framework, there would need to be a consultation requirement for amending methodologies and a more specific regime when errors are identified in methodologies.

6.7.6 Disclosure (Presentation and disclosure of credit ratings)

218. **With regard to the obligations to accompany the disclosure of a methodology underpinning an individual credit rating with a guidance**, the Mexican legal framework requires CRAs to disclose in the press release the way the ratings were determined, their features, attributes and limitations and any information that would lead to a proper understanding by the investing public of the credit rating (Annex I, Section V, Subsection A number 9 of the MCRAR). As indicated above, CRAs are also required to disclose in the press release the relevant elements related to the rating including the methodology used to grant or modify the qualification, indicating its version and date of approval, as well as the indication of the place where it can be consulted (Annex I, section II, subsection A, number 10 of the MCRAR).

219. **With regard to the prohibition of including irrelevant elements in the presentation of credit ratings and rating outlooks and the obligation to stipulate that the rating is the agency's opinion and should be relied upon to a limited degree**, the Mexican legal framework requires CRAs to include a mention that the rating is an opinion on the credit quality of the securities or entities and not an investment recommendation (Annex I, section V, subsection a) number 6 of the MCRAR). In relation to the CRA 3 requirement that credit ratings shall not present factors other than those related to the credit rating is not directly replicated in the Mexican framework. However, the principle could be seen as being replicated via Annex I section II, subsection A) number 6 of the MCRAR which requires CRAs to only issue or change a credit rating taking into account relevant information and factors that could affect the credit rating.

220. **With regard to the requirement to indicate whether the rated entity or related third party participated in the credit rating process using a clearly distinguishable different colour code for the rating category**, unsolicited ratings are not contemplated under the Mexican legal framework. As a result, there is no such requirement to include a colour code indicating whether the rated entity participated in the rating process. However, the provisions of Annex I, section V, subsection A) number 13 of the MCRAR that require a CRA to disclose through a press release the relevant elements of each credit rating. Taking this information into account (for example the list of sources of information used, including that provided by third parties), an external user could infer whether a credit rating was solicited or not.

221. **With regards to whether there is a requirement to disclose on an annual basis details regarding the CRAs revenue**, the Mexican legal framework doesn't require CRAs to annually publish information about the allocation of fees to credit ratings of different asset classes. Tenth provision, section V and VI of MCRAR request to only submit to the CNBV the annual audited financial statements as well as the list of all customers, noting the revenue from each of them and for all services provided to them. However, unlike the EU regime there is no requirement for this information to be published.

Presentation and disclosure of credit ratings

The Mexican regime has similar requirements to the EU regime in relation to the requirement to highlight in a credit rating that it is the agency's opinion. In addition, the Mexican regime has safeguards to ensure that only information relevant to the credit rating are presented in the credit ratings. There are also requirements to ensure that credit ratings are accompanied with guidance to enable users of ratings to understand them.

6.7.7 Disclosure (Periodic disclosure about the CRA and competition)

222. **With regards to whether there is a requirement for CRAs to disclose on their website and to the CNBV on an ongoing basis**, information about all entities or debt instruments submitted to it for their initial review or preliminary rating, the Mexican regulatory framework does not require CRAs to disclose on its website or to the supervisor information about all entities or debt instruments submitted to it for their initial review[28]. However, Annex 1, section V, number 7 of the MCRAR states that CRAs have to immediately disclose each credit rating that has been granted, including preliminary ratings and any modification made to them. This requirement is not applicable to private ratings (see Annex 1, section V, subsection b). Additionally, Thirteenth provision of the MCRAR states that CRAs have to provide CNBV with the list of public and private ratings as well as upgrades, downgrades and all other information required by the MCRAR.

223. **With regards to the information a CRA is required to provide to the CNBV regarding its pricing policies and the specific fees charged to clients of the CRA**, the Mexican legal framework does not require to provide CNBV with information regarding its pricing policy. There is however similar requirement to the EU regime for the CRA to provide data on fees charged to individual clients. Section VI of the Tenth provision of MCRAR requires CRAs to annually provide CNBV with the list of all customers, pointing out the revenue from each of them, detailing all services provided to each one during immediately preceding year. CRAs are also required to publicly disclose whether they have received from the same rated entity fees relating to services different from rating services and their percentage in connection with the rating services fees.

224. **With regards to whether there are any measures in place to ensure that fees charged by the CRA are non-discriminatory and cost based**, there are no identical requirements under the Mexican legal framework however there is a general requirement for CNBV to guarantee fair treatment to all CRAs' clients. Article 339 last paragraph of the SML states that the CNBV shall establish rules regarding internal controls, preventing conflicts of interest, corporate and auditing practices, transparency and fairness in the services of CRAs. Additionally, second rule, section IV of the MCRAR requires that CRA's internal Code of Conduct assures that the relationships between the CRAs and

[28] CNBV considers "initial review" as the CRA process of elaborating a credit rating prior to issuing a preliminary or a final rating.

their clients are conducted in an equitable and honest way, according with sound market practices.

Competition and general periodic disclosures

With regard to disclosures in respect of preliminary ratings, the Mexican regime has strict requirements that preliminary ratings are disclosed in the same manner as credit ratings.. With regard to disclosures of pricing policies to the supervisor and the market, there is only an obligation of reporting all fees charged for different services to the same client. Regarding protections for the clients of the CRAs to ensure that the fees they are charged are cost based and non-discriminatory, there are no identical provisions, however there are some requirements regarding performing the business in a fair and ethical manner.

Conclusion

On the basis of this assessment ESMA concludes that the Mexican legal and supervisory framework includes sufficient provisions to meet the objectives of the additional CRA 3 regulatory requirements.

6.8 Singapore

225. This section of the report explains how ESMA assesses equivalence of the legislative and supervisory framework of Singapore with the additional equivalence requirements introduced by the CRA 3 Regulation. The approach adopted has focused on the new provisions of the additional equivalence requirements, identifying the importance of any differences.

226. As such, this analysis should be read in conjunction with the 2013 Technical Advice on regulatory equivalence [29] which assessed the Singapore regulatory and supervisory framework against the broader requirements of CRA 1 Regulation, as well as the methodological framework included in Annex III.

227. In this regard, the following are the legislative and supervisory provisions that were assessed:

- Securities and Futures Act[30];
- Monetary Authority of Singapore's Code of Conduct for Credit Rating Agencies[31];
- Securities and Futures (Licensing and Conduct of Business) Regulations[32].

6.8.1 Scope of the regulatory and supervisory framework (Rating Outlooks)

228. **As regards ensuring that rating outlooks are accurate, transparent and free from conflicts of interest**, the supervisory and regulatory framework for Singapore does not recognise rating outlooks. In accordance with Part II of Schedule II of the Securities and Futures Act[33] credit rating is defined as "an opinion expressed using an established and defined ranking system of rating categories, primarily regarding the creditworthiness of a rating target'. As the Singaporean definition of credit rating is broadly similar to the EU definition, it is difficult to interpret it as having a broader application.

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[29] ESMA/2013/626 Technical advice on CRA regulatory equivalence – on Argentina, Brazil, Mexico, Hong Kong and Singapore, Available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-626_esma_technical_advice_on_equivalence_of_argentina_brazil_mexico_hong_kong_singapore_with_eu_on_cras_supervision_30_may_2013.pdf

[30] http://statutes.agc.gov.sg/aol/search/display/view.w3p;page=0;query=DocId%3A%2225de2ec3-ac8e-44bf-9c88-927bf7eca056%22%20Status%3Ainforce%20Depth%3A0;rec=0

[31] http://www.mas.gov.sg/~/media/resource/legislation_guidelines/securities_futures/sub_legislation/CRA_FAQs_17%20Jan%202012.pdf

[32] http://statutes.agc.gov.sg/aol/search/display/view.w3p;page=0;query=DocId%3A826c2643-d1f6-4d7a-984e-76b96aa3c591%20Depth%3A0%20Status%3Ainforce;rec=0;whole=yes

[33] http://statutes.agc.gov.sg/aol/search/display/view.w3p;ident=b90fb374-c529-48f9-807b-7a680a5efd92;page=0;query=DocId%3A%2225de2ec3-ac8e-44bf-9c88-927bf7eca056%22%20Status%3Ainforce%20Depth%3A0;rec=0#Sc2-.

229. The scope of the regulation is further clarified by Question 2 (d) of the Singaporean Monetary Authority's FAQ on Credit Rating Agencies which clarifies that the preparation of credit scores and related analytics, do not fall within the definition of credit ratings.

230. Taking these together it is clear that rating outlooks are not included on an explicit basis, and difficult to argue that they are included on an implicit basis.

Outlooks

In light of the above, two determinations can be made. The first is that rating outlooks are neither recognised on an explicit or implicit basis in the Singaporean regime. The second is that rating outlooks are a feature of market for credit ratings in Singapore as it is possible they could be considered under "related analytics" which are explicitly outside scope.

6.8.2 Conflicts of interest management

231. In assessing the measures a CRA is required to have in place to prevent and mitigate against conflicts of interest the relevant legislative provisions is Section 6 of the CRA Code of Conduct.

232. **As regards effective internal control structures,** Paragraph 10.1 of the CoC requires a CRA to establish an internal code of conduct. This internal code of conduct should be made publicly available. The CRA should describe how it intends to enforce the internal code of conduct and disclose any changes on a timely basis. As a part of its own internal code of conduct, Paragraph 6.1 of the Code of Conduct for CRAs requires a credit rating agency to adopt and implement written procedures and mechanisms to (a) identify, and (b) eliminate, or manage and disclose, as appropriate, any actual or potential conflicts of interest that may influence the credit ratings a CRA makes. Further to this a CRA's internal code of conduct requires that the CRA publicly discloses its conflict avoidance and management measures. In addition, Regulation 13(b)(ix) of the SF(LCB) Regulations requires that a CRA (which is a Capital Markets Services Licence holder for providing credit rating services) should ensure effective controls and segregation of duties to mitigate potential conflicts of interest that may arise from the operations of the holder.

233. **As regards conflicts of interests relating to shareholders**, the most relevant provision is Paragraph 5.4 of the CoC which states that a CRA should ensure that its credit ratings are not affected by the existence of or potential for a business relationship between the CRA (or its affiliates) and any rated entity (or its affiliates) or any other party, or the non-existence of such a relationship. While this wording does not explicitly recognise shareholders it could be argued that CRAs are required to address conflicts of interests relating to their shareholders on an implicit basis.

234. **With regards to the specific ownership thresholds of 10% and 5%,** Concerning whether a CRA is prohibited from issuing a credit rating on an entity if a board member

of the CRA or a shareholder holding more than 10% of shares or voting rights of the CRA also holds more than 10% of the shares in the rated entity, there is no like for like provision. However, Paragraph 5.4 of the CoC, could on an implicit basis be seen as requiring that its credit ratings were not affected by such a conflict of interest. However this is not as strong as a prohibition.

235. **Regarding whether there is a prohibition on an individual or entity holding more than 5% of the shares or the voting rights of a CRA from proving consultancy or advisory services to a rated entity of that CRA**, there are a number of requirements that address this without making reference to a specific threshold. Paragraph 5.5 of the CoC states that a CRA should not provide consultancy or advisory services to a rated entity or relating third party, Paragraph 5.6 of the CoC states that a CRA should not carry out any business, including consultancy or advisory services which can reasonably be considered as giving rise to a conflict of interest. Finally, Paragraph 7.5(e) states that no representative or employee of a CRA should participate in the credit rating activities or otherwise influence the determination of a credit rating if the representative or employee has, or had, a relationship with the rated entity that may cause or be perceived as causing a conflict of interest and in particular if that representative or employee owns securities in the rated entity or a related party.

Conflicts of Interest Management

The Singaporean framework for Conflicts of Interest is not as detailed or prescriptive as the EU regime. There is a requirement to establish an internal control function and internal procedures for identifying, mitigating and preventing conflicts of interest. However there is no explicit requirement to address conflicts of interest relating to shareholders. In addition, the specific thresholds for conflicts of interest arising from shareholdings of 5% and 10% are not present.

6.8.3 Confidentiality

236. **With regards to whether there is a specific definition of inside information**, Division 3 of Part XII of the Securities and Futures Act provides a definition of inside information.

237. **With regards whether the definition of inside information is extended to credit ratings, rating outlooks and information thereto,** there is no explicit provision which automatically deems credit ratings, rating outlooks and information related thereto as inside information, though it is possible they would be judged as such after the fact if they meet the standards of the definition.

238. **With regards to the internal procedures a CRA is required to put in place,** Paragraph 9.1 of the CoC requires a CRA to adopt procedures and mechanisms to protect the confidential nature of information which is shared with it by rated entities. In addition Paragraph 9.1 requires that the CRA, its representatives and employees, should not disclose confidential information on a general basis. Paragraph 9.2 requires that

CRAs only use confidential information for purposes related to its credit rating activities. Paragraph 9.3 states that CRAs should take all reasonable measures to protect all property and records belonging to or in possession of the CRA. Paragraph 9.4 requires the CRA to prohibit its representatives or employees from engaging in transactions in securities when they possess confidential information concerning the issuer of such securities. Paragraph 9.5 requires that a CRA ensures it does not selectively disclose any information that is not publicly available about credit ratings or possible future revisions of any credit rating by the CRA. Finally, a CRA should ensure that its employees do not use or share confidential information for the purpose of dealing in securities or for any purpose other than for carrying on business in providing credit rating services.

Confidentiality

Although there is a definition of inside information in the Singaporean regime, credit ratings and information related thereto are not automatically recognised as such. Although it is possible they would be judged as such after the fact. The Singaporean regime does however include detailed internal requirements for the CRA to take relating to the protection of confidential information and the steps employees of the CRA can and cannot take with respect to this information.

6.8.4 Quality of methodologies and of credit ratings (Quality of credit ratings and analysis of information used in assigning credit ratings)

239. **With regards to whether there is a requirement for a credit rating agency to submit a rating to a rated entity for review prior to its publication,** Paragraph 8.13 of the CoC states that where feasible and appropriate, prior to issuing or revising a credit rating, the CRA should inform the issuer of securities of the critical information and principal considerations upon which a credit rating should be based in order to afford the issuer an opportunity to clarify any likely factual misperceptions or other matter that may affect the quality of the credit rating.

Quality of credit ratings and analysis of information used in assigning credit ratings

Unlike the EU regime there is no strict requirement for a CRA to inform a rated entity about a credit rating prior to its publication. Instead, a CRA should only notify a rated entity when “feasible and appropriate”.

6.8.5 Quality of methodologies and of credit ratings (Quality of methodologies and changes to them)

240. **With regard to the requirement that credit ratings are issued in accordance with the published methodologies**, Paragraph 2.1 of the CoC states that a CRA should adopt and implement written procedures to ensure that the credit ratings it prepares are based on a thorough analysis of all information known to the CRA relevant to its analysis,

according to the CRAs published rating methodology. In addition, Paragraph 8.4 of the CoC requires that a CRA should indicate in each credit rating announcement the principal methodology or methodology version that was used in determining the credit rating, and where a description of that rating methodology can be found. This would therefore appear to establish that it is a requirement for credit ratings to be issued in accordance with an existing or published methodology.

241. **With regard to the obligation to consult market participants on material changes to methodologies and publish the responses**, Paragraph 8.17 states that a CRA should publicly disclose any material modification to its methodologies, models or key rating assumptions and significant practices, procedures and processes. In addition Paragraph 8.17 requires that these disclosures should be made before their going into effect. However, there is no requirement for CRAs to consult with market participants prior to making a change. As a result there is no requirement to publish the responses to a consultation.

242. **With regards to the obligation to correct, publish and report errors in methodologies to the supervisor,** there is no explicit requirement in the CoC for a CRA to address any errors in its methodologies, however there is the general requirement set out in Paragraph 2.2 for CRAs to use rating methodologies that are rigorous, systematic, and where possible, subject to back testing. In addition, paragraph 2.11 requires a CRA to establish and implement a rigorous and formal review function responsible for periodically reviewing (a) the rating methodologies and (b) the adequacy and effectiveness of its systems and internal control mechanisms. These checks should include periodic, and at least annual, reviews of the rating methodologies and models that it uses. For Structured Finance Instruments, in accordance with Paragraph 2.12 CRAs are required to assess whether existing rating methodologies and models for determining credit ratings are appropriate when the risk characteristics of the assets underlying a Structured Finance product change materially.

243. **With regards to requirements to notify affected rated entities or the supervisor, Paragraph 8.18 states that where methodologies, models or key rating assumptions used in preparing a credit rating are changed,** the CRA should disclose the likely scope of the credit ratings affected by using the same means of communication as used for distributing the ratings. While this is not an explicit requirement to inform all affected rated entities it is possible it would result in the same outcome. With regards to whether there is a requirement to notify the supervisor, there is no requirement under the CoC.

Quality of methodologies and changes to them

Under the Singaporean regime there is no explicit requirement for a CRA to correct errors in their methodologies, in addition there are no requirements to conduct a consultation on any changes to methodologies. While there is no requirement to notify all affected entities in the case of a change to a methodology, there is a requirement to publicly

communicate any change. There is however no explicit requirement to notify the supervisor of a change to a methodology.

6.8.6 Disclosure (Presentation and disclosure of credit ratings)

244. **With regard to the obligations to accompany the disclosure of a methodology underpinning an individual credit rating with guidance**, Paragraph 8.16 of the CoC requires CRAs to provide sufficiently clear, and easily comprehensible information about its published methodologies, key rating assumptions and significant practices, procedures and processes used in determining a credit rating. The purpose of these disclosures is to ensure outside parties can understand how a rating was arrived at by a CRA.

245. **With regard to the prohibition from the including of irrelevant elements in the presentation of credit ratings and rating outlooks and the obligation to stipulate that the rating is the agency's opinion and should be relied upon to a limited degree**, Paragraph 2.1 of the CoC requires that CRAs adopt and implement written procedures to ensure that the credit ratings it prepares are based on a thorough analysis of all information known to the CRA that is relevant to its analysis, according to the CRAs published rating methodology. Paragraph 2.4 of the CoC states that a CRA should ensure that the credit ratings it prepares reflect all information known, and believed to be relevant, to the CRA, consistent with its published rating methodology. More explicitly, Paragraph 5.3 of the CoC states that when assigning a credit rating a CRA should take into consideration only factors relevant to the credit assessment.

246. **With regard to the requirement to indicate whether the rated entity or related third party participated in the credit rating process using a clearly when issuing an unsolicited rating using a colour code**, there is no such requirement under the Singaporean framework.

247. **With regards to whether there is a requirement to disclose on an annual basis details regarding the CRAs revenue,** Paragraph 10.4 of the CoC requires CRAs on an annual basis to ensure that the following information relating to the CRA is made public (a) legal structure (b) ownership (c) financial information about its revenue (d) internal control mechanisms adopted by it to ensure the quality of its credit rating activities (e) its record keeping policy; and (f) its management and representative rotation policy. Taken together these provisions are equivalent to the EU requirement to publish an annual transparency report.

Presentation and disclosure of credit ratings

Under the Singapore regime there is a requirement to ensure adequate guidance accompanies a credit rating action and methodology. There are also requirements to ensure a credit rating reflects all information believed to be relevant. Finally there is a requirement that a CRA publicly discloses on an annual basis information about its legal

structure, ownership and revenue. However there is no requirement for CRAs to include a colour code indicating the rated entities participation.

6.8.7 Disclosure (Periodic disclosure about the CRA and competition)

248. **With regard to whether there is a requirement for CRAs to disclose on their website and to the SFC on an ongoing basis**, information about all entities or debt instruments submitted to it for their initial review or preliminary rating, The relevant provision with regards to the Singapore regime is Paragraph 8.9 of the CoC This provision requires CRAs to publicly disclose on a timely and ongoing basis, information concerning all structured finance instruments submitted to it for its initial review or preliminary rating. This disclosure is required to be made regardless of whether the issuer of the structured finance product engages the CRA to provide a final credit rating. However this requirement only exists for Structured Finance Instruments, not all asset classes.

249. **With regards to the information a CRA is required to provide to the SFC regarding its pricing policies**, there are no systematic requirements in the Singaporean framework to provide pricing policies of the CRA to either the supervisor or the rated entities. However the supervisor may request this information as part of its supervisory activities. In order to ensure there is some degree of transparency towards the market, Paragraph 6.3 of the CoC does require CRAs to publicly disclose the general nature of its compensation arrangements with rated entities. In addition Paragraph 6.5 of the CoC requires CRAs to disclose if it receives 5% or more of its annual revenue from a single issuer, originator, arranger etc.

250. **With regards to whether there are any measures in place to ensure that fees charged by the CRA are non-discriminatory and cost based**, there are no like for like requirements under the Singaporean regime. However, Paragraph 4.1 of the CoC requires that in providing credit rating services, a CRA and its representatives should deal fairly and honestly with issuers of securities, investors and other market participants. In addition, Paragraph 5.8 of the CoC states that a CRA should not enter into any contingent fee arrangement for providing credit rating service. While these provisions provide some comfort regarding the fair treatment of clients and the mitigation of conflicts of interest in the rating process, they are not equivalent to the EU regime.

Competition and general periodic disclosures

With regards to disclosures in respect of preliminary ratings, the Singaporean regime only extends these requirements to SFI. With regards to disclosures of pricing policies to the supervisor and the market, there are no requirements under the Singaporean regime. Regarding the measures to protect clients and ensure they are fairly treated, there are only high level requirements that do not directly match the EU provisions.

Conclusion

On the basis of this assessment ESMA concludes that the Singaporean legal and supervisory framework does not include sufficient provisions which could meet the objectives of the additional CRA 3 regulatory requirements.

6.9 United States

251. This section of the report explains how ESMA assesses equivalence of the legislative and supervisory framework of the United States with the additional equivalence requirements introduced by the CRA 3 Regulation. The approach adopted has focused on the new provisions of the additional equivalence requirements, identifying the importance of any differences.

252. As such, this analysis should be read in conjunction with the 2009 and 2012 Technical Advice on regulatory equivalence[34], which assessed the US legal and supervisory framework against the broader requirements of CRA 1 Regulation. The following key to the references and terms used in this advice:

- SEC: Securities and Exchange Commission – the competent US supervisor of NRSROs
- NRSRO: A registered CRA is known under US law as a "Nationally Recognized Statistical Rating Organization" abbreviated NRSRO

6.9.1 Scope of the regulatory and supervisory framework (Rating Outlooks)

253. The US framework provides no explicit definition of rating outlooks. However, credit watches, which as per recital 7 of CRA 3, are a type of rating outlooks within the meaning of the CRA Regulation, are referred to in a number of SEC Rules. Rule 17g-3(a)(6) (unless otherwise noted, all rules cited are promulgated pursuant to the Securities Exchange Act of 1934 (the "Exchange Act")) requires an NRSRO to annually provide the SEC with a report of the number of credit ratings actions (upgrades, downgrades, placements on credit watch, and withdrawals) taken during the fiscal year in each class of credit ratings for which it is registered. Rule 17g-8(c)(2) requires an NRSRO to establish, maintain, and enforce policies and procedures, that are reasonably designed to ensure that, when it is determined from a lookback review conducted pursuant to Section 15(E)(h)(4)(A) of the Exchange Act that a conflict of interest influenced a credit rating, the NRSRO must promptly determine whether the rating should be revised and publish, as applicable, a revised credit rating or an affirmation of the credit rating. If the credit rating is neither revised nor affirmed within 15 days of the discovery that the rating was influenced by a conflict of interest, the Rule requires that the credit rating be placed on credit watch.

[34] CESR/10-332 Technical Advice to the European Commission on the Equivalence between the US Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies https://www.esma.europa.eu/system/files_force/library/2015/11/10_332.pdf?...1 and ESMA/2012/259 Final report Technical advice on CRA regulatory equivalence - US, Canada and Australia available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2012_-259_0.pdf

Outlooks

The concept of rating outlooks within the meaning of Article 3(1)(w) of the CRA Regulation, i.e. “an opinion regarding the likely direction of a credit rating” does not exist in the US legal framework. However, the US regime does recognises rating watches, which are a type of rating outlook, as being included within the scope of the US legal framework.

6.9.2 Conflicts of interest management

254. **As regards the requirement to have effective internal control structures,** the US rules are very similar to the requirement established in Article 6(4) of the CRA Regulation. NRSROs are, in accordance with the Exchange Act Section 15E(c)(3)(A) and Rule 17g-8(d) required to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings.

255. **As regards conflicts of interests relating to shareholders,** the US rules do not provide the same explicit references to shareholders as in the CRA Regulation. However, the US rules indirectly ensure protection against conflicts of interests relating to shareholders in two ways:

256. Firstly, pursuant to Rule 17g-5(b)(6), (7) and (8), NRSROs are required to disclose and manage conflicts of interests between, on the one hand, any person *associated with an NRSRO* and, on the other hand, an issuer or obligor, or any affiliate of the obligor subject to a credit rating, or a broker dealer engaged in the business of underwriting securities or money market instruments. According to Section 3(a)(63) of the Exchange Act, a person associated with the NRSRO includes, officers and directors and any person directly or indirectly controlling, controlled by, or under common control with the NRSRO. The SEC has not published a definition of the term “control” in the context of NRSRO supervision. However, in Rule 504 of the Securities Act of 1933 control is defined as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether *through the ownership of voting securities*, by contract, or otherwise.

257. Secondly, Rule 17g-5(a) and (b) requires an NRSRO to manage and disclose certain conflicts of interest. Under Rule 17g-5(b)(10), an NRSRO is required to disclose and to establish, maintain, and enforce written policies and procedures to address and manage any type of conflict of interest relating to the issuance of credit ratings by the NRSRO that is material to the NRSRO and that is identified by the NRSRO in Exhibit 6 to Form NRSRO in accordance with Section 15E(a)(1)(B)(iv) of the Exchange Act and Rule 17g-1. Accordingly, any conflict of interest involving the shareholders of an NRSRO and relating to the issuance of credit ratings by the NRSRO would be required to be managed and disclosed if the conflict is material to the NRSRO and identified in Exhibit 6 to Form

NRSRO. However, it is left to the NRSRO to define what constitutes a material conflict within the meaning of this Rule.

258. **With regard to the specific ownership thresholds of 10% and 5%,** while, the fixed thresholds provided in the CRA Regulation are not present in the US Legal framework, the general framework is designed to protect against conflicts of interests relating to the owners and decision-makers of a CRA and rated entities. An NRSRO is prohibited from issuing or maintaining a credit rating with respect to a person associated with the NRSRO. Furthermore, Rule 17g-5(c)(5) prohibits the issuing of a credit rating where the NRSRO or a person associated with the NRSRO made recommendations to the obligor or the issuer, underwriter, or sponsor of the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security.

Conflicts of interest management

Similarly to Article 6(4) of the CRA Regulation, the US legal framework requires a CRA to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings.

While, the US legal framework includes provisions which provide protection in a situation where a shareholder could create conflicts of interests for CRA, the rules are much less prescriptive than the European rules. Specifically, the 5% and 10% thresholds provided in the CRA Regulation are not replicated in the US legal framework.

6.9.3 Organisational requirements (confidentiality)

259. **With regard to the protection of the confidentiality of a non-published rating action,** a number of safeguards are provided in US law. Rule 17g-4 prescribes that the written policies and procedures that an NRSRO establishes, maintains, and enforces to prevent the misuse of material, non-public information must include policies and procedures reasonably designed to prevent the inappropriate dissemination within and outside the NRSRO of material non-public information obtained in connection with the performance of credit rating services. This includes the inappropriate dissemination within and outside the NRSRO of a pending credit rating action before issuing the credit rating on the Internet or through another readily accessible means. The release containing the 2007 Final SEC Rules states that it is stated that *this provision* [Rule 17g-4] *recognises that a credit rating action of an NRSRO may be material, non-public information*[35]*.*

[35] SECURITIES AND EXCHANGE COMMISSION, 17 CFR Parts 240 and 249b, [Release No. 34-55857; File No. S7-04-07] RIN 3235-AJ78: Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, available at: https://www.sec.gov/rules/final/2007/34-55857.pdf

Confidentiality

Under the US regime, a credit rating or related information is not automatically considered as “material non-public information” prior to publication in the same way as under the EU regime. However, it is recognised that a non-public rating action may constitute such information and as a result it is further specified that the NRSRO should have policies and procedures in place to avoid selective and inappropriate disclosure of non-published rating actions. However, unlike the EU regime the US framework provides no obligation to keep lists of persons with access to non-published information relating to a credit rating.

6.9.4 Quality of methodologies and of credit ratings (Quality of credit ratings and analysis of information used in assigning credit ratings)

260. **With regard to the obligation to inform a rated entity in order to give it an opportunity to draw attention of the CRA to any factual errors**, the US legal framework provides no identical rule. Exhibit 2 to Form NRSRO which lists some of the information a CRA should provide when applying for status as an NRSRO includes procedures for informing rated obligors or issuers of rated securities or money market instruments about credit rating decisions and for appeals of final or pending credit rating decisions. Finally, in the release containing the 2007 Final SEC rules[36], it is recognised that: *some credit rating agencies, as part of their methodologies for determining credit ratings, will discuss a proposed credit rating action with the management of the issuer or obligor being rated to solicit their views or provide an opportunity to appeal the decision. NRSROs engaging in this practice must have procedures reasonably designed to ensure that the discussions with the issuer or obligor do not lead to the selective disclosure of the information to persons other than those persons within the issuer or obligor who are authorized to receive the information*.

Quality of credit ratings and analysis of information used in assigning credit ratings

The US legal framework contains no requirement for a CRA to provide a credit rating to the rated entity to identify factual errors prior to publication. However, this is also not prevented. An NRSRO should disclose during the registration process, the procedures it intends to follow for informing rated obligors and issuers about credit rating decisions and for appeals for final and pending credit rating decisions.

[36] SECURITIES AND EXCHANGE COMMISSION, 17 CFR Parts 240 and 249b, [Release No. 34-55857; File No. S7-04-07] RIN 3235-AJ78: Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, available at: https://www.sec.gov/rules/final/2007/34-55857.pdf

6.9.5 Quality of methodologies and of credit ratings (Quality of methodologies and changes to them)

261. **With regard to the requirement that credit rating changes are issued in accordance with published methodologies**, the US legal framework does not explicitly provide for such obligation. However, pursuant to Sections 15E(p)(3)(A) and 15E(p)(3)(B)(i) of the Exchange Act, the SEC carries out, on an annual basis, an examination to assess whether the registered NRSROs conduct business in accordance with their rating methodologies. Furthermore, in accordance with Exchange Act Section 15E(c)(3)(A), each NRSRO must establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings.

262. **With regard to the obligation to consult market participants on material changes to methodologies and publish the responses,** requirements very similar to the EU rules are provided in the US legal framework. Rule 17g-8(d) requires an NRSRO to take into account certain factors when establishing, maintaining, enforcing and documenting an effective internal control structure governing the implementation of and adherence to policies, procedures and methodologies for determining credit ratings. With respect to establishing the internal control structure, the NRSRO, among other factors, take into consideration (1) controls reasonably designed to ensure that a newly developed methodology or an update to an in-use methodology for determining credit ratings is disclosed to the public for consultation prior to the new or updated methodology being employed by the NRSRO to determine credit ratings, that the NRSRO makes comments received as part of the consultation publicly available, and that the NRSRO considers comments before implementing the methodology, and (2) controls reasonably designed to ensure that market participants have an opportunity to provide comment on whether in-use methodologies for determining credit ratings should be updated that the NRSRO makes comments received publicly available and that the NRSRO considers the comments. The US Rules do not explicitly set out a minimum time period for consultation.

263. While notification to the SEC about changes to methodologies is not required, Rule 17g-8(a)(4)(i) requires each NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that material changes to the procedures and methodologies to determine credit ratings are promptly published on an easily accessible portion of the NRSRO's website. The SEC carries out annual examinations to evaluate whether the disclosures are carried out consistent with applicable NRSRO Rules.

264. **With regard to the obligation to correct, publish and report errors in methodologies to the supervisor,** Rule 17g-8(a)(4)(ii) requires each NRSRO to establish, maintain, enforce, and document policies and procedures reasonably designed to ensure that notice of the existence of a significant error identified in a procedure or methodology used to determine credit ratings that may result in a change to current credit ratings is promptly published on an easily accessible portion of the

NRSRO's website. Notification of errors in methodologies to the SEC is not a mandatory requirement in the US. However, the SEC carries out annual examinations to evaluate whether disclosures are carried consistent with applicable NRSRO Rules.

265. Whilst the obligation to correct errors in methodologies is not explicitly stated in the US legal framework it can be inferred from several provisions such as Exchange Act Section 15E(c)(3)(A), which requires each NRSRO to establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings.

Qualities of methodologies and how to change them

The US legal framework provides safeguards which are similar to the ones required in the CRA regulation concerning consultation on changes to methodologies and publication of responses, errors and changes made. Small difference exist with regard to reporting obligation to the supervisor; where the EU rules require reporting of errors and changes in methodologies this information should under US law be published on an easily accessible part of the CRA's website. Finally, some requirements, such as the obligation to correct an identified error in a methodology is not provided explicitly but can be inferred from more general provisions regarding the quality of methodologies.

6.9.6 Disclosure (Presentation and disclosure of credit ratings)

266. **With regard to the obligations to accompany the disclosure of a methodology underpinning an individual credit rating with a guidance**, the corresponding US requirements are laid down in Rules 17g-7(a)(1)(ii)(B), (C), (D), (E), and (M). These rules require the disclosure of a credit rating to be accompanied by:

(B) the version of the procedure or methodology used to determine the credit rating;

(C) the main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating,

(D) the potential limitations of the credit rating, including the types of risks excluded from the credit rating that the NRSRO does not comment on, including, as applicable, liquidity, market, and other risks;

(E) information on the uncertainty of the credit rating; and

(M) information on the sensitivity of the credit rating to assumptions made by the NRSRO, including: [1] Five assumptions made in the ratings process that, without accounting for any other factor, would have the greatest impact on the credit rating if the assumptions were proven false or inaccurate.

267. Whilst the US requirements do not explicitly refer to “cash-flow analysis” or the need for the guidance to be clear and comprehensible, overall the requirement appears to achieve the same objective as the EU requirement.

268. **With regard to the prohibition from including irrelevant elements in the presentation of credit ratings and rating outlooks and the obligation to stipulate that the rating is the agency’s opinion and should be relied upon to a limited degree**, the US legal framework contains some similar provisions. Specifically, Paragraphs (1)(ii)(D), (E) and (M) of Rule 17g-7(a) focus on communication of the potential limitations and uncertainty of a credit rating as well as the assumptions underlying a credit rating. Rule 17g-7(a) requires an NRSRO to produce an information disclosure form at the time of any credit rating action and to publish such form in the same manner as the related credit rating. The rule specifies that the format of the form should be easy to use and helpful for users of credit ratings to understand the information contained therein. Taken together these provisions achieve the same objective as the EU rules.

269. **With regard to the requirement to indicate whether the rated entity or related third party participated in the credit rating process when issuing an unsolicited rating using a colour code**, an identical requirement does not exist in the US legal framework.

Presentation and disclosure of credit ratings

Overall, while the US regime is not identical to the EU regime, there are a number of similarities. Under the US regime there is a requirement to ensure adequate guidance accompanies a credit rating action and methodology. There are also requirements to ensure a credit rating reflects all information believed to be relevant. However there is no requirement for CRAs to include a colour code indicating participation of the rated entities.

6.9.7 Disclosure (Periodic disclosure about the CRA and competition)

270. **As regards the requirement to disclose on its website and to the supervisor information about all entities or debt instruments submitted to it for their initial review or preliminary ratings**, the US legal framework does not contain an identical provision. However, Rule 17g-2(b)(7) requires an NRSRO to retain the following records (excluding drafts of documents) that relate to its business as a credit rating agency: External and internal communications, including electronic communications, received and sent by the NRSRO and its employees that relate to initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating. This allows the SEC to monitor practices with regard to preliminary ratings and initial reviews in the contexts of its annual examinations.

271. **With regard to the obligation to periodically report fees data to the regulator,** the US legal framework contains no identical provision. However, the SEC requires NRSROs to make and retain a wide range of financial information and to report a subset of these.

Specifically, Rule 17g-2(a)(1) requires an NRSRO to make and retain records of original entry into the accounting system of the NRSRO and records reflecting entries to and balances in all general ledger accounts for each fiscal year. An account record for each person (for example, an obligor, issuer, underwriter, or other user) that has paid the NRSRO for the issuance or maintenance of a credit rating and an account record for each subscriber to the credit ratings and/or credit analysis reports of the NRSRO have to be made and retained by the NRSRO pursuant to Paragraphs (a)(3) and (a)(4) of Rule 17g-2.

272. Rule 17g-2(b)(1) requires that an NRSRO retain significant records (for example, bank statements, invoices, and trial balances) underlying the information included in the annual financial reports the NRSRO filed with or furnished to, as applicable, the Commission pursuant to Rule 17g-3. Rule 17g-3 requires that an NRSRO annually file a number of financial reports with the SEC, inter alia, a financial report listing the 20 largest issuers and subscribers that used credit rating services provided by the NRSRO by amount of net revenue attributable to the issuer or subscriber during the fiscal year as well as a financial report providing information concerning the revenue of the NRSRO in each of the following categories (as applicable) for the fiscal year, revenue from:

    a. determining and maintaining credit ratings;

    b. from subscribers;

    c. granting licenses or rights to publish credit ratings; and

    d. all other services and products (including descriptions of any major sources of revenue).

273. Furthermore, an NRSRO is required to keep records of various types of communication with its clients. Pursuant to Rules 17g-2(b)(6) and (7), an NRSRO must retain its marketing materials (this could include fees schedules) that are published or otherwise made available to persons that are not associated with the NRSRO as well as external and internal communications, including electronic communications, received and sent by the NRSRO and its employees that relate to initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating.

274. **With regard to the requirement to ensure that fees charged are not discriminatory and based on actual cost**, a similar provision is not found in the US legal framework.

275. **With regard to the public disclosure of financial information relating to registered CRAs,** the US legal framework does not contain an identical requirement. However, as set out in paragraph 270 of this document, the SEC requires extensive information relating to the revenue of an NRSRO to be recorded by the NRSRO and reported to the SEC.

Competition and general periodic disclosures

By and large the new requirements introduced by CRA 3 concerning periodical disclosures and competition are not reflected in the US legal framework. However, more general obligations to record and store information pertaining to fees and client communication contribute to achieving the objective of transparency, competition and mitigation of conflicts of interests.

Conclusion

On the basis of the above assessment ESMA concludes that the US legal and supervisory framework includes sufficient provisions to meet the objectives of the additional CRA 3 regulatory requirements.

Annex I: Letter of 17 July 2017 from the European Commission to ESMA requesting technical advice on equivalence

EUROPEAN COMMISSION
Directorate-General for Financial Stability, Financial Services and Capital Markets Union

The Director-General

Brussels, 13. 07. 2017 – 3534774
fisma.ddg.b.4/EP/js (2017)3910284

Mr Steven Maijoor
Chairman
ESMA
103 rue de Grenelle
F – 75007 Paris

Subject: ***Request for ESMA technical advice on the equivalence of certain third country legal and supervisory frameworks with the additional requirements for equivalence introduced by the EU Regulation 462/2013 of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies (hereafter the "CRA III Regulation").***

Dear Mr Maijoor,

The Regulation (EC) No 1060/2009 on credit rating agencies (the "**CRA I Regulation**") has put in place an equivalence/certification mechanism for credit rating agencies ("**CRAs**").

This mechanism enables smaller CRAs from third countries to obtain, under certain conditions[1], recognition of their credit ratings in the EU for regulatory purposes. In this view, smaller CRAs from third countries can apply for certification by ESMA, provided the legal and supervisory framework of their country of origin was recognised equivalent with EU CRA rules, by a Commission's decision (article 5 of the CRA Regulation on equivalence/certification).

There are currently nine third countries - Argentina, Australia, Brazil, Canada, Hong Kong, Japan, Mexico, Singapore, US (hereafter the "**Relevant Third Countries**") - for which the Commission adopted in the past equivalence decisions on the basis of the equivalence requirements provided in the CRA I Regulation (article 5(6)) - (hereafter the "**Initial Equivalence Decisions**").

The CRA I Regulation was amended by the Regulation 462/2013 of 21 May 2013 (the "**CRA III Regulation**") which upgraded several substantive requirements applicable to EU registered CRAs. As a result, the CRA III Regulation also introduced some additional requirements for equivalence in order to reflect these changes[2] (hereafter the "**Additional Equivalence Requirements**"). These Additional Equivalence Requirements will enter into force for equivalence purposes as of 1 June 2018[3].

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1 It applies only to small CRAs without physical presence in the EU and which are not systemically important for the financial stability or integrity of the financial markets of one or more Member States;

2 See art. 5(6)(b) as modified by the CRA III Regulation "*credit rating agencies in that third country are subject to legally binding rules which are equivalent to those set out in Articles 6 to 12 and Annex I, with the exception of Articles 6a, 6b, 8a, 8b, 8c and 11a, point (ba) of point 3 and points 3a and 3b of Section B of Annex I;*"

3 As set out in Recital 48 of the CRA III Regulation, "*credit ratings issued in third countries may be used for regulatory purposes if they are issued by credit rating agencies certified in accordance with that Regulation or endorsed by credit rating agencies established in the Union in accordance with that Regulation. Certification requires that the Commission has adopted an equivalence decision regarding the third country's regulatory regime for credit rating agencies and endorsement requires that the conduct of the third-country credit rating agency fulfils requirements which are at least as stringent as the relevant Union rules. In order to grant third countries sufficient time to review their regulatory frameworks regarding the*

Consequently, the Commission must assess whether the legal and supervisory framework of the Relevant Third Countries ensures that the same objectives and effects are achieved as the ones aimed by the Additional Equivalence Requirements introduced by the CRA III Regulation.

In line with the requirements of Article 38(3) of the CRA Regulation and with the previous exchanges between DG FISMA and ESMA services, ESMA is invited to provide the Commission with a technical advice assessing the equivalence of the legal and supervisory framework of the Relevant Third Countries with the above mentioned Additional Equivalence Requirements. On the working approach, ESMA is invited to take into account the principles listed in Annex to this letter.

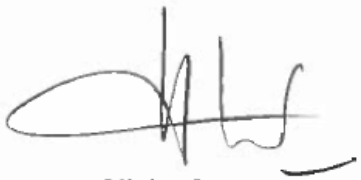
As regards the initial equivalence requirements assessed for the adoption of the Initial Equivalence Decisions, I am taking this opportunity to encourage ESMA to continue monitoring actively the continuous compliance of the Relevant Third Countries legal and supervisory framework with these initial requirements.

Following ESMA's above-mentioned technical advice, the Commission will determine whether the Relevant Third Countries have legislative and supervisory frameworks that are equivalent to the applicable equivalence requirements and adopt a decision following the procedure under Article 5(6) of the CRA III Regulation.

DG FISMA services and ESMA have a successful cooperation record in working together in the preparation of implementing and delegated legislation for EU legal acts. Therefore, I am confident that you will be able to provide us with the necessary technical advice **before the 8th of November 2017**, as agreed at services' level. DG FISMA remains at your disposal for any assistance in this respect.

I thank you in advance for your cooperation on this matter.

Yours sincerely,



Olivier Guersent

Annex

Working approach for the Technical Advice

ESMA is invited to take account of the following principles in its Technical Advice:

- ESMA should provide comprehensive technical analysis of the equivalence of the legislative and supervisory framework of the Relevant Third Countries with the Additional Equivalence Requirements introduced by the CRA III Regulation (taking also into account the corresponding recitals);

- This technical assessment should focus on the differences between the substantive provisions of the Additional Equivalence Requirements and the third country framework in question. ESMA should evaluate and give its judgment on the material importance of such differences. In doing so it should focus on technical criteria and not take into account any considerations of a political nature;

- In addition, ESMA should also assess whether the supervisory arrangements available in the Relevant Third Countries can ensure effective compliance of local CRAs with the national legislative provisions that reflect the objectives of the Additional Equivalence Requirements;

- ESMA should address to the Commission any questions they might have concerning the clarification on the text of the CRA Regulation, which they would consider of relevance to the preparation of its technical advice;

- The technical analysis carried out should contain sufficient and detailed explanations for the assessment done, and be presented in an easily understandable language respecting current legal terminology used in the field of securities markets and company law at European level;

- In case where ESMA's advice to the Commission would be that there is no equivalence between the legal and supervisory regime of the Relevant Third Countries and the Additional Equivalence Requirements of the CRA III Regulation, ESMA is invited to identify clearly those areas where significant discrepancies exist. It is also invited to suggest any solutions which could be considered by the Commission to overcome such discrepancies. Such solutions could be sought from that third country in the context of expected bilateral discussions between the Commission and the third country authorities concerned in order to reach a positive outcome of the equivalence assessment.

Annex II: List of material changes introduced by CRA 3

Table: Overview of material changes introduced by CRA with relevance to equivalence and corresponding changes made to ESMA's Methodological Framework for assessing equivalence.

ID	Changes to the CRA Regulation introduced by CRA 3	Addressed in the updated methodology:
1	**Amended Provision Article 6(1) and 6(3)** 1. A credit rating agency shall take all necessary steps to ensure that the issuing of a credit rating or a rating outlook is not affected by any existing or potential conflicts of interest or business relationship involving the credit rating agency issuing the credit rating or the rating outlook, its shareholders, managers, rating analysts, employees or any other natural person whose services are placed at the disposal or under the control of the credit rating agency, or any person directly or indirectly linked to it by control. […] 3. At the request of a credit rating agency, ESMA may exempt a credit rating agency from complying with the requirements of points 2, 5, 6 and 9 of Section A of Annex I and Article 7(4) if the credit rating agency is able to demonstrate that those requirements are not proportionate in view of the nature, scale and complexity of its business and the nature and range of issue of credit ratings and that: […]	35. These requirements involve the need for CRAs to: (a) identify and eliminate or alternatively manage and disclose conflicts of interest including those relating to shareholders of the CRA; […] 43. However, ESMA can accept the following differences: […] (e) The requirement mentioned in point (f) of paragraph 35 above. ESMA accepts that thresholds in a third country may be different or that the third-country legislation does not explicitly address shareholders requirements. However, the third-country laws and regulations should provide sufficient protection against the risk that the interests of a significant shareholder impacts on the independence of the CRA, its analysts and/or its credit ratings/rating outlooks.
2	**New Provision Article 6(4)** 4. Credit rating agencies shall establish, maintain, enforce and document an effective internal control structure governing the implementation of policies and procedures to prevent and mitigate possible conflicts of interest and to ensure the independence of credit ratings, rating analysts and rating teams regarding shareholders, administrative and management bodies and sales and marketing activities. Credit rating agencies shall establish standard operating procedures (SOPs) with regard to corporate governance, organisation, and the management of conflicts of interest. They shall periodically monitor and review those SOPs in order to evaluate their effectiveness and assess whether they should be updated.	35. These requirements involve the need for CRAs to: […] (n) establish, maintain, enforce and document an effective internal control structure governing the implementation of policies and procedures to prevent and mitigate possible conflicts of interest and to ensure the independence of credit ratings, rating analysts and rating teams regarding shareholders, administrative and management bodies and sales and marketing activities.

3	**Amended Provision Article 7(5)** 5. Compensation and performance evaluation of employees involved in the credit rating activities or rating outlooks, as well as persons approving the credit ratings or rating outlooks, shall not be contingent on the amount of revenue that the credit rating agency derives from the rated entities or related third parties.	**Not incorporated as change since it is not considered substantial**
4	**Amended Provision Article 8(2)** 2. A credit rating agency shall adopt, implement and enforce adequate measures to ensure that the credit ratings and the rating outlooks it issues are based on a thorough analysis of all the information that is available to it and that is relevant to its analysis according to the applicable rating methodologies. It shall adopt all necessary measures so that the information it uses in assigning credit ratings and rating outlooks is of sufficient quality and from reliable sources. The credit rating agency shall issue credit ratings and rating outlooks stipulating that the rating is the agency's opinion and should be relied upon to a limited degree."	99. In addition, according to Article 8(2), 8(2a), 10(2)-(2a) and paragraphs (1), (2), (4) of Section D of Annex I of the CRA Regulation, CRAs should ensure that the following information is indicated in the credit ratings or rating outlooks: […] (i) a statement that an issued credit rating or rating outlook is the agency's opinion and should be relied upon to a limited degree. 100. […] However, ESMA can accept the following differences for the purposes of endorsement or equivalence: […] (e)points (h) and (i) of paragraph 99 may be achieved by means other than an explicit legal requirement;
5	**New Provision Article 8(2a)** 2a. Changes in credit ratings shall be issued in accordance with the credit rating agency's published rating methodologies.	99. In addition, according to Article 8(2), 8(2a), 10(2)-(2a) and paragraphs (1), (2), (4) of Section D of Annex I of the CRA Regulation, CRAs should ensure that the following information is indicated in the credit ratings or rating outlooks: […] (j) if the credit rating constitutes a change of an existing credit rating it should be issued in accordance with the CRA's published rating methodologies.
6	**Amended Provision Article 8(5)** 5. A credit rating agency shall monitor credit ratings and review its credit ratings and methodologies on an ongoing basis and at least annually, in particular where material changes occur that could have an impact on a credit rating. A credit rating agency shall establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings. Sovereign ratings shall be reviewed at least every six months.	**Not incorporated as it relates to sovereign ratings**
7	**New Article 8(5a)**	87. These requirements impose an obligation on CRAs to:

	5a. A credit rating agency that intends to make a material change to, or use, new rating methodologies, models or key rating assumptions which could have an impact on a credit rating shall publish the proposed material changes or proposed new rating methodologies on its website inviting stakeholders to submit comments for a period of one month together with a detailed explanation of the reasons for and the implications of the proposed material changes or proposed new rating methodologies.	(d) publish any proposed material changes or proposed new rating methodologies on its website inviting stakeholders to submit comments for a period of one month together with a detailed explanation of the reasons for and the implications of the proposed material changes or proposed new rating methodologies; […] 88. ESMA considers that these requirements are significant in ensuring that the CRA is able to achieve the overall objective of these requirements. However, ESMA does not expect identical requirements to be hard-wired into a third-country regulatory framework. In particular, ESMA may accept that points (d)-(g) are not in place if the third-country supervisory and legal framework ensures an adequate level of quality, rigour and transparency of rating methodologies through other means.
8	**New Provision Article 8(6aa-ab)** 6. Where rating methodologies, models or key rating assumptions used in credit rating activities are changed in accordance with Article 14(3), a credit rating agency shall: (a) immediately, using the same means of communication as used for the distribution of the affected credit ratings, disclose the likely scope of credit ratings to be affected; (aa) immediately inform ESMA and publish on its website the results of the consultation and the new rating methodologies together with a detailed explanation thereof and their date of application; (ab) immediately publish on its website the responses to the consultation referred to in paragraph 5a except in cases where confidentiality is requested by the respondent to the consultation;	87. These requirements impose an obligation on CRAs to (e) immediately inform the competent supervisor and publish on its website the results of the consultation and the new rating methodologies together with a detailed explanation thereof and their date of application; (f) immediately publish on its website the responses to the consultation relating to changes in rating methodologies except in cases where confidentiality is requested by the respondent to the consultation; […] 88. ESMA considers that these requirements are significant in ensuring that the CRA is able to achieve the overall objective of these requirements. However, ESMA does not expect identical requirements to be hard-wired into a third-country regulatory framework. In particular, ESMA may accept that points (d)-(g) are not in place if the third-country supervisory and legal framework ensures an adequate level of quality, rigour and transparency of rating methodologies through other means.
9	**New Provision Article 8(7)** 7. Where a credit rating agency becomes aware of errors in its rating methodologies or in their application it shall immediately:	87. These requirements impose an obligation on CRAs to (g) notify identified errors in methodologies to the supervisor and all affected rated entities explaining the impact on its ratings

	(a) notify those errors to ESMA and all affected rated entities explaining the impact on its ratings including the need to review issued ratings (b) where errors have an impact on its credit ratings, publish those errors on its website; (c) correct those errors in the rating methodologies; and (d) apply the measures referred to in points (a), (b) and (c) of paragraph 6.	including the need to review issued ratings; where errors have an impact on its credit ratings, publish those errors on its website; and correct those errors in the rating methodologies. […] 88. ESMA considers that these requirements are significant in ensuring that the CRA is able to achieve the overall objective of these requirements. However, ESMA does not expect identical requirements to be hard-wired into a third-country regulatory framework. In particular, ESMA may accept that points (d)-(g) are not in place if the third-country supervisory and legal framework ensures an adequate level of quality, rigour and transparency of rating methodologies through other means.
10	**New Provision Article 8d** **Article 8d Use of multiple credit rating agencies** 1. Where an issuer or a related third party intends to appoint at least two credit rating agencies for the credit rating of the same issuance or entity, the issuer or a related third party shall consider appointing at least one credit rating agency with no more than 10 % of the total market share, which can be evaluated by the issuer or a related third party as capable of rating the relevant issuance or entity, provided that, based on ESMA's list referred to in paragraph 2, there is a credit rating agency available for rating the specific issuance or entity. Where the issuer or a related third party does not appoint at least one credit rating agency with no more than 10 % of the total market share, this shall be documented. 2. With a view to facilitating the evaluation by the issuer or a related third party under paragraph 1, ESMA shall annually publish on its website a list of registered credit rating agencies, indicating their total market share and the types of credit ratings issued, which can be used by the issuer as a starting point for its evaluation. 3. For the purposes of this Article, total market share shall be measured with reference to annual turnover generated from credit rating activities and ancillary services, at group level.	**Not incorporated as it "*only establish*[es] *obligations on issuers but not on credit rating agencies"* (Recital 48).**
11	**Amended Provision Article 10(1) and (2)** 1. A credit rating agency shall disclose any credit rating or rating outlook, as well as any decision to discontinue a credit rating, on a non-selective basis and in a timely	98. Namely, pursuant to Article 10(1), (4), (5), (6) Article 11(2), and paragraph (5) of Section D of Annex I of the CRA Regulation, CRAs are required to:

	manner. In the event of a decision to discontinue a credit rating, the information disclosed shall include full reasons for the decision. The first subparagraph shall also apply to credit ratings that are distributed by subscription. 2. Credit rating agencies shall ensure that credit ratings and rating outlooks are presented and processed in accordance with the requirements set out in Section D of Annex I and shall not present factors other than those related to the credit ratings.	(g) in presenting credit ratings or rating outlooks, avoid presenting factors other than those related to the credit ratings. 99. However, ESMA can accept the following differences for the purposes of endorsement or equivalence: […] (f) point (g) of paragraph 98 may be achieved by other means, for example through a general requirement that the presentation of the credit rating may not be misleading.
12	**New Provision Article 10(2a)** 2a. Until disclosure to the public of credit ratings, rating outlooks and information relating thereto, they shall be deemed to be inside information as defined in, and in accordance with, Directive 2003/6/EC. Article 6(3) of that Directive shall apply mutatis mutandis to credit rating agencies as regards their duty of confidentiality and their obligation to maintain a list of persons who have access to their credit ratings, rating outlooks or related information before disclosure. The list of persons to whom credit ratings, rating outlooks and information relating thereto are communicated before being disclosed shall be limited to persons identified by each rated entity for that purpose.	62. According to Article 10(2a) of the CRA Regulation, credit ratings, rating outlooks and information relating thereto, shall be treated as inside information, until the moment when they have been disclosed to the public. 63. ESMA considers these requirements to be very important for the reasons set out above, and it expects the objectives of these requirements to be met for the purposes of assessing equivalence.
13	**Amended Provision Article 10(5)** 5. When a credit rating agency issues an unsolicited credit rating, it shall state prominently in the credit rating whether or not the rated entity or related third party participated in the credit rating process and, using a clearly, distinguishable different colour code for the rating category, whether the credit rating agency had access to the accounts, management and other relevant internal documents of the rated entity or a related third party.	98. Namely, pursuant to Article 10(1), (4), (5), (6) Article 11(2), and paragraph (5) of Section D of Annex I of the CRA Regulation, CRAs are required to: (d) […] whilst required by the CRA Regulation, it is not necessary that it is a legal requirement in the third country that the latter is indicated using a clearly, distinguishable different colour code for the rating category;
14	**Amended provisions, Annex I, Section B, paragraph 1** 1. A credit rating agency shall identify, eliminate, or manage and disclose, clearly and prominently, any actual or potential conflicts of interest that may influence the analyses and judgments of its rating analysts, employees, or any other natural person whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in credit rating activities and persons approving credit ratings and rating outlooks.	**Not incorporated as change not considered substantial**
15	**Amended provisions, Annex I, Section B, paragraph 3(aa)-(ca)**	35. These requirements involve the need for CRAs to:

	3. A credit rating agency shall not issue a credit rating or a rating outlook in any of the following circumstances, or shall, in the case of an existing credit rating or rating outlook, immediately disclose where the credit rating or rating outlook is potentially affected by the following: (a) the credit rating agency or persons referred to in point 1, directly or indirectly owns financial instruments of the rated entity or a related third party or has any other direct or indirect ownership interest in that entity or party, other than holdings in diversified collective investment schemes, including managed funds such as pension funds or life insurance; (aa) a shareholder or member of a credit rating agency holding 10 % or more of either the capital or the voting rights of that credit rating agency or being otherwise in a position to exercise significant influence on the business activities of the credit rating agency, holds 10 % or more of either the capital or the voting rights of the rated entity or of a related third party, or of any other ownership interest in that rated entity or third party, excluding holdings in diversified collective investment schemes and managed funds such as pension funds or life insurance, which do not put him in a position to exercise significant influence on the business activities of the scheme; (b) the credit rating is issued with respect to the rated entity or a related third party directly or indirectly linked to the credit rating agency by control; (c) a person referred to in point 1 is a member of the administrative or supervisory board of the rated entity or a related third party; or (ca) a shareholder or member of a credit rating agency holding 10 % or more of either the capital or the voting rights of that credit rating agency or being otherwise in a position to exercise significant influence on the business activities of the credit rating agency, is a member of the administrative or supervisory board of the rated entity or a related third party; (d) a rating analyst who participated in determining a credit rating, or a person who approved a credit rating, has had a relationship with the rated entity or a related third party which may cause a conflict of interests. A credit rating agency shall also immediately assess whether there are grounds for re-rating or withdrawing the existing credit rating or rating outlook.	[…] (f) not issue a credit rating or in the case of an existing credit rating, immediately disclose that the credit rating is potentially affected in the circumstances set out in Annex 1 Section B paragraph 3 of the CRA Regulation for example situations where a shareholder holding 10 % or more of either the capital or the voting rights of that CRA or being otherwise in a position to exercise significant influence on the business activities of the CRA is also a significant shareholder or a board member of the rated entity; 43. However, ESMA can accept the following differences: […] (e) the requirement mentioned in point (f) of paragraph 62 above. ESMA accepts that thresholds in a third country may be different or that the third-country legislation does not explicitly address shareholders requirements. However, the third-country laws and regulations should provide sufficient protection against the risk that the interests of a significant shareholder impacts on the independence of the CRA, its analysts and/or its credit ratings/rating outlooks.
16	**New provision Annex I, Section B, paragraph 3c** 3c. A credit rating agency shall ensure that fees charged to its clients for the provision of credit rating and ancillary services are not discriminatory and are based	93. According to paragraph 3c of Section B of Annex I of the CRA Regulation, a CRA should ensure that fees charged to its clients for the provision of credit rating and ancillary services are not

	on actual costs. Fees charged for credit rating services shall not depend on the level of the credit rating issued by the credit rating agency or on any other result or outcome of the work performed.	discriminatory and are based on actual costs. Fees charged for credit rating services shall not depend on the level of the credit rating issued by the CRA or on any other result or outcome of the work performed. If this requirement is not in place, ESMA considers that there should be other safeguards to ensure that the objectives of avoiding conflicts of interests and promoting fair competition are achieved.
17	**Amended provision Annex I, Section B, paragraph 4** 4. Neither a credit rating agency nor any person holding, directly or indirectly, at least 5 % of either the capital or voting rights of the credit rating agency or being otherwise in a position to exercise significant influence on the business activities of the credit rating agency shall provide consultancy or advisory services to the rated entity or a related third party regarding the corporate or legal structure, assets, liabilities or activities of that rated entity or related third party.	36. In addition to the above: (a) a CRA as well as individuals and entities, who are in a position to exercise significant influence on the business activities of a CRA are prohibited from providing consultancy or advisory services to a rated entity or a related third party;
18	**New provision Annex I, Section C, paragraphs 7-8** 7. A person referred to in point 1 shall not take up a key management position with the rated entity or a related third party within six months of the issuing of a credit rating or rating outlook. 8. For the purposes of Article 7(4): (a) credit rating agencies shall ensure that the lead rating analysts shall not be involved in credit rating activities related to the same rated entity or a related third party for a period exceeding four years; (b) credit rating agencies other than those appointed by an issuer or a related third party and all credit rating agencies issuing sovereign ratings shall ensure that: (i) the rating analysts shall not be involved in credit rating activities related to the same rated entity or a related third party for a period exceeding five years; (ii) the persons approving credit ratings shall not be involved in credit rating activities related to the same rated entity or a related third party for a period exceeding seven years. The persons referred to in points (a) and (b) of the first subparagraph shall not be involved in credit rating activities related to the rated entity or a related third party referred to in those points within two years of end of the periods set out in those points.’;	**Not incorporated as change not considered substantial** **This requirement reduces the scope of an existing obligation rather than creating a new obligation.**

19	**New provision Annex I, Section D, Subsection I paragraph 2(f) And second subparagraph** 2. A credit rating agency shall ensure that at least: […] (f) in the case of a rating outlook, the time horizon is provided during which a change in the credit rating is expected. When publishing credit ratings or rating outlooks, credit rating agencies shall include a reference to the historical default rates published by ESMA in a central repository in accordance with Article 11(2), together with an explanatory statement of the meaning of those default rates.	98.In addition, according to Article 8(2), 8(2a), 10(2)-(2a) and paragraphs (1), (2), (4) of Section D of Annex I of the CRA Regulation, CRAs should ensure that the following information is indicated in the credit ratings or rating outlooks: […] (h)a reference to the historical default rates together with an explanatory statement of the meaning of those default rates; 99. […] However, ESMA can accept the following differences for the purposes of endorsement or equivalence: […] (e)points (h) and (i) of paragraph 126 may be achieved by means other than an explicit legal requirement;
20	**Amended provision Annex I, Section D, Subsection I paragraph 2a** 2a. A credit rating agency shall accompany the disclosure of rating methodologies, models and key rating assumptions with guidance which explains assumptions, parameters, limits and uncertainties surrounding the models and rating methodologies used in credit ratings, including simulations of stress scenarios undertaken by the credit rating agency when establishing the credit ratings, credit rating information on cash-flow analysis it has performed or is relying upon and, where applicable, an indication of any expected change in the credit rating. Such guidance shall be clear and easily comprehensible.	101. Finally, the entry into force of CRA 3 has expanded the scope of two disclosure requirements in Section D of Annex I, which were previously limited to structured financed instruments: (a) Paragraph 2a, a CRA should accompany the disclosure of methodologies, models and key rating assumptions with guidance explaining the assumptions, parameters, limits and uncertainties surrounding the models and methodologies used in such credit ratings as well as any expected change of the credit rating;
21	**Amended provision Annex I, Section D, Subsection I paragraph 3** 3. The credit rating agency shall inform the rated entity during working hours of the rated entity and at least a full working day before publication of the credit rating or the rating outlook. That information shall include the principal grounds on which the credit rating or rating outlook is based in order to give the rated entity an opportunity to draw attention of the credit rating agency to any factual errors.	80. These requirements are set out in Articles 8(2), 8(5), 10(2), and part I of Section D of Annex of the CRA Regulation. These requirements are: […] (d) to inform the entity subject to the rating during working hours of the rated entity and at least a full working day before publication of the credit rating including the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the CRA to any factual errors; […] 84. In respect of the requirement set out in paragraph 107 d) above, ESMA does not consider it necessary that there is a specific requirement that the CRA to inform the rated entity at least a full

		working day before the publication of a credit rating. Other timeframes may be acceptable as long as the CRA provides to the rated entity with the opportunity to draw attention to possible factual errors.
22	**Amended provision Annex I, Section D, Subsection I paragraph 6** 6. A credit rating agency shall disclose on its website, and notify ESMA on an ongoing basis, information about all entities or debt instruments submitted to it for their initial review or for preliminary rating. Such disclosure shall be made whether or not issuers contract with the credit rating agency for a final rating.	101. Finally, the entry into force of CRA 3 has expanded the scope of two disclosure requirements in Section D of Annex I, which were previously limited to structured financed instruments: […] (b) paragraph 6, a CRA shall disclose on its website, and notify ESMA on an ongoing basis, information about all entities or debt instruments submitted to it for their initial review or for preliminary rating. Such disclosure shall be made whether or not issuers contract with the CRA for a final rating 102. An important objective of the requirement in paragraph 101(b) above is to limit the risk of rating shopping. This objective may be achieved through other means.
23	**New provision Annex I, Section D, Subsection III** **III. Additional obligations in relation to sovereign ratings** 1. Where a credit rating agency issues a sovereign rating or a related rating outlook, it shall simultaneously provide a detailed research report explaining all the assumptions, parameters, limits and uncertainties and any other information taken into account in determining that sovereign rating or rating outlook. That report shall be publicly available, clear and easily comprehensible. 2. A publicly available research report accompanying a change compared to the previous sovereign rating or related rating outlook shall include at least the following: (a) a detailed evaluation of the changes to the quantitative assumption justifying the reasons for the rating change and their relative weight. The detailed evaluation should include a description of the following: per capita income, GDP Growth, inflation, fiscal balance, external balance, external debt, an indicator for economic development, an indicator for default and any other relevant factor taken into account. This should be complemented with the relative weight of each factor; (b) a detailed evaluation of the changes to the qualitative assumption justifying the reasons for the rating change and their relative weight;	**Not incorporated as it relates to sovereign ratings**

	(c) a detailed description of the risks, limits and uncertainties related to the rating change; and (d) a summary of minutes of the meeting of the rating committee that decided on the rating change. 3. Without prejudice to point 3 of Part I of Section D of Annex I, where a credit rating agency issues sovereign ratings or related rating outlooks, it shall publish them in accordance with Article 8a, after the close of business hours of regulated markets and at least one hour before their opening. 4. Without prejudice to point 5 of Part I of Section D of Annex I, in accordance with which, when announcing a credit rating, a credit rating agency is to explain in its press releases or reports the key elements underlying the credit rating and although national policies may serve as an element underlying a sovereign rating, policy recommendations, prescriptions or guidelines to rated entities, including States or regional or local authorities of States, shall not be part of sovereign ratings or rating outlooks.	
24	**New provision Annex I, Section E, Subsection II** (a) list of fees charged to each client for individual credit ratings and any ancillary services; (aa) its pricing policy, including the fees structure and pricing criteria in relation to credit ratings for different asset classes; and […]	114. Article 11(3) and paragraph (2) of Part II of Section E of Annex I of the CRA Regulation require CRAs to provide, on an annual basis, to the competent authority: […] (c) the pricing policy, including the fees structure and pricing criteria in relation to credit ratings for different asset classes. 115. ESMA expects the third-country legal and supervisory framework to impose some form of disclosure requirement regarding revenue generation by the CRA and that the third-country supervisor has the power to request all the information listed above.
25	**New provision Annex I, Section E, Subsection III, paragraph 3** **III. Transparency report** A credit rating agency shall make available annually the following information: […] 3. statistics on the allocation of its staff to new credit ratings, credit rating reviews, methodology or model appraisal and senior management, and on the allocation of staff to rating activities with regard to the different asset classes (corporate — structured finance — sovereign);	118. In addition, under Article 12 and Part III of Section E of Annex I of the CRA Regulation, CRAs are required to make the following information available to the public on an annual basis in an annual report on their internet website: […] (e) statistics on the allocation of their staff to new credit ratings, credit rating reviews, methodologies or model appraisals and senior management, and on the allocation of staff to rating

		activities with regard to the different asset classes (corporate — structured finance — sovereign); and […] 119. Whilst according to the CRA Regulation these requirements need to be disclosed to the public, ESMA considers disclosure to the authority is adequate. In addition, ESMA considers that it can accept that CRAs are not required to disclose the statistics referred to under letter e) in paragraph 118 above.
26	**Amended provision Annex I, Section E, Subsection III, paragraph 7** **III. Transparency report** A credit rating agency shall make available annually the following information: […] 7. financial information on the revenue of the credit rating agency, including total turnover, divided into fees from credit rating and ancillary services with a comprehensive description of each, including the revenues generated from ancillary services provided to clients of credit rating services and the allocation of fees to credit ratings of different asset classes. Information on total turnover shall also include a geographical allocation of that turnover to revenues generated in the Union and revenues worldwide.	118. In addition, under Article 12 and Part III of Section E of Annex I of the CRA Regulation, CRAs are required to make the following information available to the public on an annual basis in an annual report on their internet website: […] (g) financial information on the revenue of the credit rating agency, including total turnover, divided into fees from credit rating and ancillary services with a comprehensive description of each, including the revenues generated from ancillary services provided to clients of credit rating services and the allocation of fees to credit ratings of different asset classes. Information on total turnover shall also include a geographical allocation of that turnover to revenues generated in the Union and revenues worldwide 119. Whilst according to the CRA Regulation these requirements need to be disclosed to the public, ESMA considers disclosure to the authority is adequate. […] The level of detail concerning the disclosures mentioned in letter g) do not need to be identical to the EU requirements.
27	**Transversal: Rating Outlooks** The requirements to credit ratings are extended to cover rating outlooks as well. The words and/or “rating outlook” have thus been added after the words “credit rating” in the following provisions: **Provisions quoted above** Article 6(1); Article 7(5); Article 8(2); Article 10(1), (2) and (2a); Annex I, Section B, paragraph 1 and 3; Annex I, Section C, paragraph 7;	32. While the CRA Regulation provides a definition of a rating outlook in Article 3(1)(w), ESMA may accept that no such explicit definition is provided in a third-country legal framework. However, rating outlooks should be covered by the same safeguards that ensure the quality, independence, timely disclosure and confidentiality of credit ratings.

	Annex I, Section D, Subsection I, paragraph 2(f) and 3; and Annex I, Section D, Subsection III, paragraphs 1-4. **Annex I, Section B, paragraph 7** 7. 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: (a) for each credit rating and rating outlook decision, the identity of the rating analysts participating in the determination of the credit rating or rating outlook, the identity of the persons who have approved the credit rating or rating outlook, information as to whether the credit rating was solicited or unsolicited, and the date on which the credit rating action was taken; (b) the account records relating to fees received from any rated entity or related third party or any user of ratings; (c) the account records for each subscriber to the credit ratings or related services; (d) the records documenting the established procedures and rating methodologies used by the credit rating agency to determine credit ratings and rating outlooks (e) the internal records and files, including non-public information and work papers, used to form the basis of any credit rating and rating outlook decision taken; **Annex I, Section C, paragraphs 2 and 3(b)** 2. No person referred to in point 1 shall participate in or otherwise influence the determination of a credit rating or rating outlook of any particular rated entity if that person: (a) owns financial instruments of the rated entity, other than holdings in diversified collective investment schemes; (b) owns financial instruments of any entity related to a rated entity, the ownership of which may cause or may be generally perceived as causing a conflict of interest, other than holdings in diversified collective investment schemes; (c) has had a recent employment, business or other relationship with the rated entity that may cause or may be generally perceived as causing a conflict of interest. 3. Credit rating agencies shall ensure that persons referred to in point 1: […]	

	(b) do not disclose any information about credit ratings, possible future credit ratings or rating outlooks of the credit rating agency, except to the rated entity or a related third party; […] **Annex I, Section D, Subsection I, paragraphs 1, 2(a), and 2(d)** **Section D Rules on the presentation of credit ratings and rating outlooks** I. General obligations 1. A credit rating agency shall ensure that any credit rating and rating outlook states clearly and prominently the name and job title of the lead rating analyst in a given credit rating activity and the name and position of the person primarily responsible for approving the credit rating or rating outlook. 2. A credit rating agency shall ensure that at least: (a) all substantially material sources, including the rated entity or, where appropriate, a related third party, which were used to prepare the credit rating or rating outlook are indicated together with an indication as to whether the credit rating or rating outlook has been disclosed to that rated entity or related third party and amended following that disclosure before being issued; […] (d) the date at which the credit rating was first released for distribution and when it was last updated including any rating outlooks is indicated clearly and prominently […] **Annex I, Section D, Subsection I, paragraphs 4 and 5** 4. A credit rating agency shall state clearly and prominently when disclosing credit ratings or rating outlooks any attributes and limitations of the credit rating or rating outlook. In particular, a credit rating agency shall prominently state when disclosing any credit rating or rating outlook whether it considers satisfactory the quality of information available on the rated entity and to what extent it has verified information provided to it by the rated entity or a related third party. If a credit rating or a rating outlook involves a type of entity or financial instrument for which historical data is limited, the credit rating agency shall make clear, in a prominent place, such limitations.	

	In a case where the lack of reliable data or the complexity of the structure of a new type of financial instrument or the quality of information available is not satisfactory or raises serious questions as to whether a credit rating agency can provide a credible credit rating, the credit rating agency shall refrain from issuing a credit rating or withdraw an existing rating. 5. When announcing a credit rating or a rating outlook, a credit rating agency shall explain in its press releases or reports the key elements underlying the credit rating or the rating outlook. **Annex I, Section E, Subsection I, paragraph 3** A credit rating agency shall generally disclose the fact that it is registered in accordance with this Regulation and the following information: […] 3. sthe policy of the credit rating agency concerning the publication of credit ratings and other related communications including rating outlooks;	

Annex III: Methodological framework for assessing equivalence

1. For the purposes of this assessment, ESMA has grouped the requirements from the CRA Regulation into different sections depending on the objective each provision seeks to address. These sections are discussed in further detail below and are as follows:

    1 Scope of the regulatory and supervisory framework

    2 Corporate governance

    3 Conflicts of interest management

    4 Organisational requirements

        4.1 General organisational requirements

        4.2 Outsourcing

        4.3 Confidentiality

        4.4 Record Keeping

    5 Quality of methodologies and quality of ratings

        5.1 Reviewing credit ratings, methodologies, models and assumptions and information used in issuing ratings

        5.2 Knowledge and experience of employees directly involved in credit rating activities

        5.3 Quality of credit ratings and analysis of information used in assigning credit ratings

        5.4 Quality of methodologies and changes to them

        5.5 Competition

    6 Disclosure

        6.1 Presentation and disclosure of credit ratings

        6.2 General and periodic disclosure about the CRA

    7 Effective supervision and enforcement

        7.1 The methods that the third-country authority has in place to ensure that it is adequately staffed

        7.2 Powers of the third country authority

        7.3 Sanctions

1 Scope of the Regulatory and supervisory framework

2. Ensuring that the nature of the legal and supervisory framework in place is able to meet the same overall objectives as the EU regulatory regime is key. If ESMA is not satisfied that the framework is able to do this, then a positive conclusion of the assessment cannot be reached.

3. As such, the following needs to be in place to meet the requirements for equivalence:

   (a) there has to be some form of legally binding regulatory and supervisory framework for CRAs in place (5(6)(b) of the CRA Regulation);

   (b) CRAs have to be subject to what ESMA considers to be effective ongoing supervision and enforcement (for what ESMA considers this to be see sub-section (4.7) *Effective Supervision and Enforcement* below (5(6)(a) of the CRA Regulation)(;

   (c) CRAs are subject to some form of registration or authorisation process (5(6)(a) of the CRA Regulation);

   (d) the scope of the activities of a CRA that are subject to the third-country legal and supervisory framework includes the scope of activities that is included in the EU regime (Article 3(1)(a), (b) and (w) of the CRA Regulation);

   (e) the relevant authority is prohibited from influencing the content of ratings and methodologies (5(6)(c) of the CRA Regulation).

4. In respect of the points above, point b) is further developed in subsection 4.7 below regarding what ESMA considers needs to be in place for effective ongoing supervision and enforcement.

5. Of the other requirements set out in paragraph 2 above, it is point d) that needs further elaboration below. There needs to be legal clarity regarding what a CRA is, or the activities that it conducts are, and these need to broadly cover what the CRA Regulation covers. While the CRA Regulation provides a definition of a rating outlook in Article 3(1)(w), ESMA may accept that no such explicit definition is provided in a third-country legal framework. However, rating outlooks should be covered by the same safeguards that ensure the quality, independence, timely disclosure and confidentiality of credit ratings.

6. Where exemptions are permissible according to third-country laws and regulations, such exemptions need to be considered in order to verify that they do not hamper the compliance with the objectives of the CRA Regulation.

7. Looking at the requirements of the CRA Regulation, this means that the definition of a CRA or the activities that it conducts do not need to be identical, but they need to cover the same scope of what is covered by the CRA Regulation, ensuring that the credit ratings that are subject to the oversight of the third-country regulatory framework in question and that could be used in the EU are covered.

8. ESMA will look at the legal definition of what a CRA is, what activities of the agency are covered and also at the nature of the exemptions that can be applied.

9. In looking at the definition of a CRA, ESMA will consider whether or not the definition means that individuals as opposed to legal entities could be considered as CRAs, as this could have implications for the recourse of those relying on those ratings.

10. A definition of CRAs, which is broader in scope than the EU definition, is acceptable for the purposes of equivalence.

11. ESMA points out that a third-country legal and supervisory framework may not require all CRAs to be registered or authorised with the relevant authority, but only those that want to enable their ratings to be used for what ESMA considers to be those circumstances covered by Article 4(1) of the CRA Regulation (referred to as “use for regulatory purposes” in this document) need to be registered or authorised.

12. ESMA highlights that Articles 4 and 5 of the CRA Regulation make specific reference to the use of credit ratings issued in a third country for regulatory purposes in the EU and require the CRA in question to be registered or authorised in that third country.

13. In addition, ESMA highlights that it does not expect the concept of “use for regulatory purposes” in a third-country legal and supervisory framework to be the same.

14. In cases where the third-country legal and supervisory framework is broad, although ESMA has been mandated to assess the third-country framework as a whole, for the purposes of equivalence, ESMA is only focusing on those aspects of the third country framework that relate to the use of credit ratings for “regulatory purposes”.

Exemptions

15. In terms of assessing the exemptions that can be applied and how the authority in question exercises its discretion in respect of these exemptions, any exemptions need to be assessed for the following reasons.

16. If there are no exemptions set out in the third-country legal and supervisory framework, then this is acceptable for the purposes of equivalence because, the exemptions allowed under the CRA Regulation exist in order to facilitate competition, recognising that the nature, scale, and complexity of a CRA’s business and the nature and range of its credit ratings, may in certain circumstances warrant that the agency can be exempted from complying with some of the CRA Regulation’s requirements.

17. Where exemptions are allowed, ESMA looks at what the nature of these exemptions are or can be, looking at whether it is ensured that:

"users of ratings in the EU would benefit from equivalent protections in terms of CRA's integrity, transparency, good governance and reliability of the credit rating activities." [37]

18. ESMA must be satisfied that the exemptions do not prevent the achievement of this objective in practice, and there is legal clarity as to how the authority will exercise its discretion in respect of applying exemptions for attaining registered or authorisation status.

2 Corporate governance

19. Corporate governance is a core aspect of the CRA Regulation and as such sets out a large number of detailed and prescriptive requirements in Section A of Annex I of the CRA Regulation.

20. ESMA considers that the key objectives of the CRA Regulation's requirements with respect to corporate governance are to ensure that senior management is responsible and legally accountable for ensuring:

    (a) that credit ratings activities are independent;

    (b) that there is proper management of conflicts of interest; and

    (c) compliance with the legal requirements of the regulatory framework.

21. ESMA points out that, as set out in recitals 28, 29 and 30 of the CRA Regulation, corporate governance arrangements are necessary to ensure that credit ratings are independent, objective, and of adequate quality.

22. The CRA Regulation sets out a number of corporate governance requirements that need to be in place in order to ensure that a CRA is able to demonstrate its ability to meet these objectives, and its compliance with them.

23. In assessing the equivalence of a third-country legal and supervisory framework, ESMA assesses whether the requirements set out in Article 6(2) and Section A of Annex I of the CRA Regulation are in place.

24. These requirements involve the need for a CRA to have:

    (a) an administrative or supervisory board ("board");

    (b) at least 2 independent members of the board tasked with monitoring the:

        i. credit rating policy;

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[37] Section 2.3 in the Mandate from the European Commission: Brussels, 12 June 2009 | MARKT/G3/MTF/mg Ares (2009). Letter addressed to Mr Eddy Wymeersch Chairrnan Committee of European Securities Regulators (CESR). Subject: Request for CESR technical advice on the equivalence between certain third country legal and supervisory frameworks and the EU Regulatory Regime for credit rating agencies. Published as a part of CESR's "*Technical Advice to the European Commission on the Equivalence between the Japanese Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies*" Date: 9th June 2010, Ref.: CESR/10- 333 available at https://www.esma.europa.eu/sites/default/files/library/2015/11/10_333.pdf.

ii. effectiveness of the internal quality control system;

iii. internal controls and measures established to deal with conflicts of interest.

25. These requirements also involve the need for a CRA to ensure that:

(a) the compensation of the independent members of the board is not linked to the business performance of the CRA, and that their judgment can be exercised in an independent manner;

(b) the term of office of the independent members of the administrative or supervisory board is for a pre-agreed fixed period and is not renewable;

(c) a term limit for the independent member of the board is defined;

(d) the majority of members of the board, including independent members have sufficient expertise in financial services;

(e) if the CRA issues credit ratings of structured finance instruments, at least one independent member and one other member of the board has in-depth knowledge and experience at a senior level of the markets in structured finance instruments;

(f) in addition to the overall responsibility of the board, the independent members of the administrative or supervisory board have the specific task of monitoring:

i. development of credit rating policy;

ii. development of the methodologies the CRA uses in credit rating activities;

iii. effectiveness of internal control mechanisms in relation to credit rating activities;

iv. effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or adequately managed and disclosed;

v. compliance and governance processes including the efficiency of the review function.

26. ESMA anticipates that there may be significant differences in the corporate governance requirements in a third country, and as such is not expecting all of the above requirements to be in place.

27. However, ESMA considers that for the purposes of assessing equivalence, there needs to be some form of requirement that a corporate governance structure is in place to ensure that senior management is accountable.

28. In respect of the requirements relating to the independent directors that are tasked with monitoring certain activities, ESMA considers that what is important and needs as a minimum to be in place is that there is a clear allocation of the following monitoring tasks in terms of overall responsibility to the senior management:

(a) the development of credit rating policy and of the methodologies used by the CRA in its credit rating activities;

(b) effectiveness of the internal quality control system;

(c) effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or managed and disclosed; and

(d) compliance and governance processes.

29. ESMA points out that it considers that these monitoring tasks do not need to be carried out by senior management per se, but in order for the objective of the EU requirement to be met, what is important is that these monitoring tasks are carried out by someone independent, who is not involved in credit rating activities, and whose compensation is arranged in such a way to ensure the independence of their judgment and the absence of links to the business performance of the CRA.

30. Considering the importance of the specific monitoring tasks and the overall responsibilities of senior management, these tasks and functions are to be ideally carried out by those who have sufficient expertise in financial services and, where relevant for the business of the CRA, an appropriate in-depth knowledge and experience of the markets in structured finance instruments.

3 Conflicts of interest management

31. ESMA points out that conflicts of interest management is a core requirement of the CRA Regulation in order to ensure that it meets the overall objective.

32. ESMA considers the objectives of the conflicts of interest management requirements of the CRA Regulation are to ensure:

(a) objectivity, independence, integrity, and quality of the credit ratings;

(b) transparency about the credit ratings; and

(c) the protection of investors and financial markets.

33. The CRA Regulation sets out a number of detailed requirements that have to be met by CRAs in order to ensure that these objectives are achieved.

34. In assessing a third-country legal and supervisory framework, ESMA assesses whether the requirements set out in Article 6, Article 7(2)-(5) and Sections A, B, and C if Annex I of the CRA Regulation are in place in addition to those aspects of conflicts of interest covered in the corporate governance section above.

35. These requirements involve the need for CRAs to:

(a) identify and eliminate or alternatively manage and disclose conflicts of interest including those relating to shareholders of the CRA;

(b) be organised in a manner that ensures that its business interests do not impair the independence and accuracy of its credit rating activities;

(c) establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate, or manage and disclose any conflicts of interest;

(d) identify, eliminate, or manage and disclose clearly and prominently any actual or potential conflicts of interest that may influence the analyses and judgment of its ratings analysts, employees, and other natural persons whose services are placed at the disposal or under the control of the CRA and who are directly involved in the issuance of credit ratings and persons approving credit ratings;

(e) publicly disclose the names of the rated entities or related third parties from which it receives more than 5% of its annual revenue;

(f) not issue a credit rating or in the case of an existing credit rating, immediately disclose that the credit rating is potentially affected in the circumstances set out in Annex 1 Section B paragraph 3 of the CRA Regulation for example situations where a shareholder holding 10 % or more of either the capital or the voting rights of that CRA or being otherwise in a position to exercise significant influence on the business activities of the CRA is also a significant shareholder or a board member of the rated entity;

(g) ensure that the provision of ancillary services do not present conflicts of interest with its credit rating activity, and disclose in final rating reports any ancillary services provided for the rated entity or any related third party;

(h) design its reporting and communication channels so as to ensure independence of related persons from the other activities of the CRA carried out on a commercial basis;

(i) ensure that compensation and performance evaluation of the rating analysts and persons approving the credit ratings are not linked to the amount of revenue they generate;

(j) disclose any actual and potential conflicts of interest;

(k) have requirements whereby those who know of illegal conduct by others report it to the compliance officer without negative consequences;

(l) require that where a rating analyst terminates his or her employment and joins a rated entity, in the credit rating of which the analyst has been involved, or a financial firm, with which the rating analyst has had dealings as part of his or her duties at the CRA, the CRA is required to review the relevant work of the analyst preceding his departure;

(m) establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings; and

(n) establish, maintain, enforce and document an effective internal control structure governing the implementation of policies and procedures to prevent and

mitigate possible conflicts of interest and to ensure the independence of credit ratings, rating analysts and rating teams regarding shareholders, administrative and management bodies and sales and marketing activities.

36. In addition to the above:

    (a) a CRA as well as individuals and entities, who are in a position to exercise significant influence on the business activities of a CRA are prohibited from providing consultancy or advisory services to a rated entity or a related third party;

    (b) credit rating analysts or persons approving ratings are prohibited from making proposals or recommendations on the design of structured finance products about which the CRA is expected to issue a rating; and

    (c) credit rating analysts are prohibited from being involved in the negotiation of fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control.

37. In addition those persons referred to in paragraph (1) of Section C of Annex 1 of the CRA Regulation are prohibited from:

    (a) engaging in transactions in financial instruments issued, guaranteed or otherwise supported by the rated entity;

    (b) participating in or otherwise influencing the determination of a credit rating if those persons own financial instruments of the rated entity or any entity related to a rated entity or have had a recent employment or other business relationship with the rated entity that may cause a conflict of interest;

    (c) soliciting or accepting monies, gifts or favours from anyone with whom the CRA does business; and

    (d) taking key management positions with the rated entity or its related third party within 6 months after the rating.

38. Overall, as can be seen from the above requirements, the EU approach to conflicts of interest management is a combination of requirements relating to how:

    - to ensure the CRA is organised so that conflicts of interest are managed;
    - to disclose certain interests which are considered to be a potential conflict;
    - to prohibit the CRA itself and those who are involved in the credit rating process from conducting certain activities;
    - to ensure that those who are key to determining the credit rating of credit rated entities and their instruments do not establish working relationships that may result in conflict; and

- to ensure that the compensation of those involved in credit rating activities ensures the independence of their judgment.

39. This is another area where ESMA recognises that the approach to this may differ in a third country for example by setting out in the law a list of prohibited activities that are considered *de facto* to be conflicts of interest and are prohibited irrespective of the procedures and processes that a CRA may have in place.

40. ESMA recognises that the third-country laws and regulations in this area may not be as detailed or specific as those set out in the CRA Regulation.

41. However, ESMA points out that conflicts of interest management is fundamental to the ability of the CRA Regulation to achieve its objectives and does expect, that there are robust provisions embedded into the law that cover actual or potential conflicts of interest management and disclosure.

42. As such, ESMA considers that, in addition to those aspects of corporate governance set out in paragraphs 19 to 30 above, overall, the objectives of each individual conflict of interest management requirement described in paragraphs 35 to 37 above should be met through provisions embedded in the third country legal and regulatory framework, together with proper and effective supervision and enforcement.

43. However, ESMA can accept the following differences:

    (a) disclosure regarding the names of clients from whom the CRA receives more than 5% of its annual revenue can be made only to the regulator so that it can monitor and supervise how the CRA is managing the conflicts that may arise in respect of these clients;

    (b) requirements that relate to the need to review the work of the rating analyst prior to its departure to a rated entity do not need to be in place because this duplicates other requirements that would pick this issue up;

    (c) requirements prohibiting certain individuals from taking key management positions with the rated entity or its related third party within 6 months after the rating – do not need to be in place because the conflict that is being addressed would be captured by other requirements;

    (d) requirements relating to rotation of certain individuals; and

    (e) the requirement mentioned in point (f) of paragraph 35 above. ESMA accepts that thresholds in a third country may be different or that the third-country legislation does not explicitly address shareholders requirements. However, the third-country laws and regulations should provide sufficient protection against the risk that the interests of a significant shareholder impacts on the independence of the CRA, its analysts and/or its credit ratings/rating outlooks.

44. ESMA recognises that the requirements relating to the gradual rotation of rating analysts and persons approving credit ratings is one of a number of ways in which a CRA can

achieve the objectives of the management of conflicts of interest requirements as set out in paragraph 32 above and the independence of rating analysts and persons approving ratings.

45. ESMA also recognises that these requirements are controversial in the sense that some market players consider such requirements as having the effect of potentially damaging the quality of ratings by diluting expertise, as well as being in contradiction to those requirements relating to knowledge and experience.

46. Others, on the other hand, welcome it as they consider it a good discipline to have to ensure that knowledge and expertise is shared as well as the ensuring that the nature of the working relationship between the credit rating analysts and the rated entity remains impartial.

47. ESMA does not consider it necessary that rotation requirements are in place in order to achieve the objective, but where there are no such requirements ESMA expects for example the legal requirements relating to conflicts of interest management to be very robust.

4 Organisational requirements

48. ESMA considers that the overall objective of the organisational requirements is to contribute to ensuring the objectivity, independence, integrity, and quality of the credit rating activities.

49. The CRA Regulation sets out a number of organisational requirements that CRAs need to have in place in order to be able to demonstrate its ability to meet these objectives and compliance with them.

50. These requirements can be divided as follows:

    I) General organisational requirements;

    II) Outsourcing;

    III) Confidentiality; and

    IV) Record keeping.

4.1 General organisational requirements

51. Article 6(2) and paragraphs (3)-(6), (8), (10) of Section A of Annex I of the CRA Regulation requires the CRA to:

    (a) establish adequate policies and procedures that ensure compliance of its obligations under the relevant regulation;

(b) have sound administrative and accounting procedures, internal control mechanisms designed to secure compliance with decisions and procedures at all levels, effective procedures for risk assessment, effective control and safeguard arrangements for information processing systems;

(c) implement and maintain decision making procedures and organisational structures that clearly and in a documented manner specify reporting lines and allocates functions and responsibilities;

(d) establish and maintain a permanent and effective compliance function which operates independently;

(e) employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of its credit rating activities; and

(f) monitor and evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with the authorities' requirements and take appropriate measures to address any deficiencies.

52. In respect of the above requirements, ESMA considers that these are necessary to facilitate the CRA's ability to achieve the objectives set out in paragraph 48 above, although it does not expect the identical requirements to be hard wired into a third-country regulatory framework.

53. ESMA needs to take an in-depth look at what organisational requirements are in place as a package, and in addition consider the nature and extent of the supervisory and enforcement powers and practices that are in place, as discussed in Section G below.

54. Having assessed what is in place as a package, ESMA considers that the overall organisational requirements must objectively achieve the purposes discussed above in order to be assessed equivalent to the EU requirements.

55. As such, for example ESMA can accept that there may not be an identical requirement set out in the law to have a permanent and effective compliance function which operates independently, but it does expect the objective of this requirement to be somehow in place.

4.2 Outsourcing

56. Article 9 of the CRA Regulation prohibits outsourcing of important operational functions in such a way so as to impair materially the quality of the CRA's internal control and the ability of the authorities to supervise the credit ratings agency's compliance under the CRA Regulation.

57. In assessing the equivalence of this prohibition, ESMA asked a number of questions to establish:

(a) if any outsourcing of important operational functions is allowed;

(b) if any restrictions in respect of outsourcing exist; and

(c) whether or not the regulatory framework ensures that:

i. none of the outsourced functions impair the quality of the CRA's internal controls; and

ii. that the outsourcing does not impair the ability of the relevant authority to supervise the CRA's compliance with its regulatory obligations.

58. In respect of these requirements, ESMA considers that, where outsourcing is allowed in the third country, for the purposes of a positive assessment of the equivalence, the third-country regulatory framework shall set out conditions for outsourcing aimed at ensuring that the following objectives are achieved:

(a) none of the outsourced functions impair the quality of the CRA's internal controls, and

(b) the ability of the authority to supervise the CRA's compliance with its legal obligations is not impaired.

59. In addition, ESMA expects that if outsourcing is allowed:

(a) there needs to be legal clarity regarding what can be outsourced; and

(b) the legal responsibility for what is being outsourced shall remain with the CRA.

4.3 Confidentiality

60. Requirements relating to confidentiality are important because of the nature of the information that the CRA and its employees have access to. There is a need to ensure that confidential information is only used for purposes related to credit rating activities and is protected from fraud, theft or misuse.

61. The CRA Regulation imposes a number of confidentiality obligations on rating analysts, employees of the CRA as well individuals whose services are placed at the disposal or under the control of the CRA and who are directly involved in credit rating activities as well as individuals closely associated with them as set out in Article 7(3) and Annex I Section C paragraph 3 of the CRA Regulation as follows:

(a) to take all reasonable measures to protect property and records in possession of the CRA from fraud, theft or misuse;

(b) to not disclose any information about credit ratings or future ones other than to the rated entity or its related third party;

(c) to keep information entrusted to the CRA confidential; and

(d) to not use or share confidential information for trading purposes or any other purpose other than credit rating activities.

62. According to Article 10(2a) of the CRA Regulation, credit ratings, rating outlooks and information relating thereto, shall be treated as inside information, until the moment when they have been disclosed to the public.

63. ESMA considers these requirements to be very important for the reasons set out above, and it expects the objectives of these requirements to be met for the purposes of assessing equivalence.

4.4 Record Keeping

64. Effective record keeping enables a CRA to document the manner in which it meets its legal obligations, as well as allowing its regulator to supervise that this is being done.

65. Article 6(2) and paragraphs (7)-(9) of Section B of Annex I of the CRA Regulation require CRAs to keep adequate records and, where appropriate, audit trails of their credit rating activities for at least five years and make them available upon request to the competent authority.

66. ESMA considers this requirement to be crucial but can accept that the period of time for which records need to be kept may differ from jurisdiction to jurisdiction, but whatever is in place has to be reasonable.

5 Quality of Methodologies and Quality of Ratings

67. In addition to the general organisational requirements referred to above, the CRA Regulation sets out a number of requirements aimed at ensuring the following objectives:

    (a) that the methodologies, models and key rating assumptions that are used in credit rating activities are rigorous, continuous and thorough;

    (b) the adequate quality, integrity and thoroughness of the credit rating activities;

    (c) the protection of the stability of financial markets and of investors as set out in recital 7 of the CRA Regulation; and

    (d) that ratings and methodologies are subject to validation as well as the adequate quality and thoroughness of ratings.

68. These requirements are set out in Article 6(2) – paragraph (9) of Section A of Annex I, Article 7(1), Articles 8(2), 8(3), 8(4), 8(5), 8(6), Article 10(2) and part I of Section D of Annex I of the CRA Regulation, and can be divided into the following areas:

    I) Reviewing credit ratings, methodologies, models and assumptions and information used in issuing ratings;

    II) Knowledge and experience of employees directly involved in credit rating activities;

III) Quality of credit ratings and analysis of information used in assigning credit ratings;

IV) Quality of methodologies and changes to them; and

V) Competition.

5.1 Reviewing credit ratings, methodologies, models and assumptions and information used in issuing ratings

69. The CRA Regulation sets out a number of requirements dealing with the review of credit ratings, methodologies, models and assumptions as well as the need to review the information used in issuing ratings in Article 8(2), Article 8(5), Article 8(6) and paragraph (9) of Section A of Annex I.

70. These requirements require a CRA to:

(a) have a review function devoted to the periodical review of methodologies, models, key rating assumptions;

(b) monitor its ratings and methodologies on an on-going basis and at least annually; and

(c) review the affected credit ratings as soon as possible and not later than within 6 months after the change, and in the meantime place those ratings under observation.

71. ESMA considers it important that methodologies are up-to-date and subject to a comprehensive review on a periodic basis.

72. ESMA does not consider it necessary for there to be a separate review function per se, but that whatever requirements are in place, that these achieve a periodic review of methodologies, models, and key rating assumptions by those who are independent from those that are responsible for the development and use of these models, key rating assumptions, and models.

5.2 Knowledge and experience of employees directly involved in credit rating activities

73. The CRA Regulation sets out requirements relating to the nature of the knowledge and experience of CRA's employees directly involved in credit rating activities in Article 7(1).

74. This requirement is that the CRA ensures that rating analysts, employees of the CRA, and any other natural person directly involved in credit rating activities have appropriate knowledge and experience for the duties assigned.

75. ESMA considers it important that those involved in credit rating activities have the necessary skills and knowledge to carry out their respective responsibilities, and that this is an area that needs to be covered in the relevant third-country framework.

76. ESMA recognises that the EU requirement has embedded a test of appropriateness, which is subjective and is something that will need to be assessed on a case-by-case basis.

77. The question is therefore whether embedding the “appropriateness” requirement in law means that in practice those doing the job are appropriately qualified, and who is best placed to assess this.

78. ESMA considers that the lack of an appropriateness test in a requirement can still result in the objective of the provision being met, provided there is disclosure regarding those individuals doing the job, and the ability to take legal action where it is clear in practice that those doing it are not appropriate.

5.3 Quality of credit ratings and analysis of information used in assigning credit ratings

79. The CRA Regulation sets out a number of requirements dealing with the quality of ratings and the information that credit rating analysts have to use when assigning ratings, as well as ensuring that the information is up to date and accurate.

80. These requirements are set out in Articles 8(2), 8(5), 10(2), and part I of Section D of Annex of the CRA Regulation. These requirements are:

    (a) to adopt, implement and enforce adequate measures to ensure that the credit ratings they issue are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis according to their rating methodologies;

    (b) to adopt all necessary measures so that the information they use in assigning a credit rating is of sufficient quality and from reliable sources;

    (c) to establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings;

    (d) to inform the entity subject to the rating during working hours of the rated entity and at least a full working day before publication of the credit rating including the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the CRA to any factual errors;

    (e) to refrain from issuing a credit rating or withdraw an existing rating if they do not have sufficient quality information to base their ratings on; and

    (f) to establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings.

81. ESMA considers these requirements are important for the purposes of achieving the objective of ensuring that the ratings being issued are robust, well founded and based on reliable information and overall are of adequate quality.

82. ESMA does not expect to see identical requirements in the third-country legal and supervisory framework however, it expects to see requirements that are able to achieve this objective.

83. In respect of the requirement set out in paragraph 80 c) above, ESMA does not consider that this needs to be addressed by a separate requirement as is the case in the CRA Regulation because it expects this to be covered in the obligation to ensure that ratings are based on accurate and up to date information.

84. In respect of the requirement set out in paragraph 80 d) above, ESMA does not consider it necessary that there is a specific requirement that the CRA to inform the rated entity at least a full working day before the publication of a credit rating. Other timeframes may be acceptable as long as the CRA provides to the rated entity with the opportunity to draw attention to possible factual errors.

85. In respect of the requirement set out in paragraph 80(f) above, and as discussed in paragraphs 44 to 47 above, ESMA does not consider it necessary that there is a specific requirement that the CRA establishes a gradual rotation mechanism.

5.4 Quality of methodologies and changes to them

86. The CRA Regulation sets out a number of requirements relating to the quality of methodologies and what needs to be done when methodologies, models or key rating assumptions used in credit rating activities are changed, as set out in Article 8(3) and 8(6) (a)-(c) of the CRA Regulation.

87. These requirements impose an obligation on CRAs to:

(a) use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing;

(b) apply the changes in methodologies and models consistently to existing ratings; and

(c) immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distributions of the affected credit ratings.

(d) publish any proposed material changes or proposed new rating methodologies on its website inviting stakeholders to submit comments for a period of one month together with a detailed explanation of the reasons for and the implications of the proposed material changes or proposed new rating methodologies;

(e) immediately inform the competent supervisor and publish on its website the results of the consultation and the new rating methodologies together with a detailed explanation thereof and their date of application;

(f) immediately publish on its website the responses to the consultation relating to changes in rating methodologies except in cases where confidentiality is requested by the respondent to the consultation; and

(g) notify the supervisor of identified errors in methodologies and all affected rated entities explaining the impact on its ratings including the need to review issued ratings; where errors have an impact on its credit ratings, publish those errors on its website; and correct those errors in the rating methodologies.

88. ESMA considers that these requirements are significant in ensuring that the CRA is able to achieve the overall objective of these requirements. However, ESMA does not expect identical requirements to be hard-wired into a third-country regulatory framework. In particular, ESMA may accept that points (d)-(g) are not in place if the third-country supervisory and legal framework ensures an adequate level of quality, rigour and transparency of rating methodologies through other means.

5.5 Competition

89. The CRA Regulation has a number of requirements relating to the rating of structured finance products where the CRA has not rated the underlying assets of the product.

90. These requirements are set out in Article 8(4) of the CRA Regulation. Article 8(4) imposes a prohibition on the CRA to refuse to issue a credit rating of an entity or a financial instrument because a portion of the entity or the financial instrument had been previously rated by another CRA, where a CRA is using an existing credit rating prepared by another CRA with respect to underlying assets or structured finance instruments;

91. According to Article 8(4) a CRA shall, furthermore, record all instances where in its credit rating process it departs from existing credit ratings prepared by another CRA with respect to underlying assets or structured finance instruments providing a justification for the differing assessment.

92. ESMA does not consider that these requirements need to be in place.

93. According to paragraph 3c of Section B of Annex I of the CRA Regulation, a CRA should ensure that fees charged to its clients for the provision of credit rating and ancillary services are not discriminatory and are based on actual costs. Fees charged for credit rating services shall not depend on the level of the credit rating issued by the CRA or on any other result or outcome of the work performed. If this requirement is not in place, ESMA considers that there should be other safeguards to ensure that the objectives of avoiding conflicts of interests and promoting fair competition are achieved.

6 Disclosure

94. The information that has to be disclosed either to the public or the supervisor in respect of credit ratings and the CRA and its activities forms another set of core prescriptive requirements.

95. For the purposes of equivalence, ESMA has subdivided the CRA Regulation's disclosure requirements as follows:

    I) Presentation and disclosure of credit ratings.

    II) General and periodic disclosure about the CRA.

6.1 Presentation and disclosure of credit ratings

96. In light of the number of presentation and disclosure of ratings requirements, for the purposes of this advice, ESMA has further categorized these requirements into:

    (a) General provisions on the presentation and disclosure of any credit ratings; and

    (b) Additional requirements in respect of the presentation and disclosure of credit ratings for structured finance products.

6.1.1 General provisions on the presentation and disclosure of any credit ratings

97. The CRA Regulation sets out a number of detailed requirements relating to the disclosure and presentation of ratings. ESMA considers that the objectives of these requirements aim at ensuring that ratings are disclosed in a timely manner and in a non-selective basis, and that adequate information is provided to the users of credit ratings in order to allow them to conduct their own due diligence when assessing whether or not to rely on those credit ratings.

98. Namely, pursuant to Article 10(1), (4), (5), (6) Article 11(2), and paragraph (5) of Section D of Annex I of the CRA Regulation, CRAs are required to:

    (a) disclose any credit rating, as well as any decisions to discontinue a credit rating, on a non-selective basis and in a timely manner;

    (b) refrain from using the name of the competent authority in such a way that would indicate endorsement or approval by that authority of the credit rating or any credit rating activities of the CRA;

    (c) disclose its policies and procedures regarding unsolicited credit ratings and ensure that unsolicited credit ratings are identified as such;

    (d) in the case of an unsolicited credit rating, information on whether or not the rated entity or related third party participated in the credit rating process and whether the CRA had access to the accounts and other relevant internal documents of

the rated entity or its related third party – whilst required by the CRA Regulation, it is not necessary that it is a legal requirement in the third country that the latter is indicated using a clearly, distinguishable different colour code for the rating category;

(e) when announcing a credit rating, to explain in their press releases or reports the key elements underlying the credit rating;

(f) make available information on its historical performance data, including the rating transition frequency and information about credit ratings issued in the past and their changes; and

(g) in presenting credit ratings or rating outlooks, avoid presenting factors other than those related to the credit ratings.

99. In addition, according to Article 8(2), 8(2a), 10(2)-(2a) and paragraphs (1), (2), (4) of Section D of Annex I of the CRA Regulation, CRAs should ensure that the following information is indicated in the credit ratings or rating outlooks:

(a) the name and job title of the lead rating analysts as well as the name and the position of the person primarily responsible for approving the rating;

(b) all substantially material sources used to prepare the credit rating, with an indication of whether the credit rating has been disclosed to that rated entity or its related third party and amended following that disclosure;

(c) the principal methodology or methodology version that was used in determining the rating, with a reference to its comprehensive description;

(d) the meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitive analysis of the relevant key rating assumptions, accompanied by an explanation of the worst-case and best-case scenario credit ratings;

(e) the date of first release of the credit rating for publication as well as of its last update;

(f) information on whether the credit rating concerns a new financial instrument and whether the CRA is rating it for the first time;

(g) any attributes and limitations of a credit rating, and in particular to what extent the CRA has examined the quality of information used in the rating process and whether it is satisfied with the quality of information it bases its rating on;

(h) a reference to the historical default rates together with an explanatory statement of the meaning of those default rates;

(i) a statement that an issued credit rating or rating outlook is the agency's opinion and should be relied upon to a limited degree; and

(j) if the credit rating constitutes a change of an existing credit rating it should be issued in accordance with the CRA's published rating methodologies.

100. ESMA considers that, for the purposes of equivalence, overall, the objectives of each individual requirement described in paragraphs 98 to 99 above should be met through provisions embedded in the third country legal and regulatory framework, together with proper and effective supervision and enforcement. However, ESMA can accept the following differences for the purposes of equivalence:

(a) decisions to discontinue a credit rating are to be disclosed, but there is no requirement to indicate the reasons for such a decision;

(b) the requirement, when announcing a credit rating, for press releases or reports to indicate the key elements underlying the credit rating, provided that it is ensured that such key elements are provided to investors when ratings are announced;

(c) the name and job title of the lead rating analysts as well as the name and the position of the person primarily responsible for approving the rating are not to be disclosed in the credit rating, provided that record of this information is kept;

(d) credit ratings are not required to indicate whether the credit rating concerns a new financial instrument and whether the CRA is rating it for the first time, since it expects this requirement to be covered through the requirement to indicate the attributes and limitations of the credit ratings that are disclosed;

(e) points (h) and (i) of paragraph 99 may be achieved by means other than an explicit legal requirement; and

(f) point (g) of paragraph 98 may be achieved by other means, for example through a general requirement that the presentation of the credit rating may not be misleading.

101. Finally, the entry into force of CRA 3 has expanded the scope of two disclosure requirements in Section D of Annex I, which were previously limited to structured financed instruments:

(a) Paragraph 2a, a CRA should accompany the disclosure of methodologies, models and key rating assumptions with guidance explaining the assumptions, parameters, limits and uncertainties surrounding the models and methodologies used in such credit ratings as well as any expected change of the credit rating; and

(b) paragraph 6, a CRA shall disclose on its website, and notify ESMA on an ongoing basis, information about all entities or debt instruments submitted to it for their initial review or for preliminary rating. Such disclosure shall be made whether or not issuers contract with the CRA for a final rating.

102. An important objective of the requirement in paragraph 101(b) above is to limit the risk of rating shopping. This objective may be achieved through other means.

6.1.2 Additional requirements in respect of the presentation and disclosure of credit ratings for structured finance instruments

103. The CRA Regulation imposes additional requirements in respect of the presentation and disclosure of ratings related to structured financial instruments.

104. The aim of these requirements is to ensure that ratings for structured financial instruments are clearly identifiable as such, and that investors receive appropriate information to deal with the additional complexity of these products.

105. Namely, Article 10(3) CRA Regulation requires CRAs that rate structured finance instruments to ensure that credit categories attributed to those structured finance instruments are clearly differentiated by the use of a specific symbol.

106. In addition, CRAs that rate structured financial instruments are required to provide in the relevant credit ratings the additional information set out in paragraphs (1), (2) of Part II of Section D of Annex I of the CRA Regulation, as detailed below:

    (a) all information about loss and cash-flows analysis performed or relied upon by the CRA as well as about expected changes in the credit rating; and

    (b) information on whether the CRA has performed any assessment concerning the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments (specifying what level of assessment) or whether the CRA has relied on a third party assessment.

107. Taking into account the complexity of structured finance products, ESMA considers it important that additional requirements are in place for the presentation and disclosure of credit ratings related to these types of products.

108. Out of the requirements set out in paragraphs 105-106 above, ESMA considers that it shall be, as a minimum, ensured that information is disclosed about the level of assessment, if any, conducted by the CRA on the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments.

6.2 General and periodic disclosure about the CRA

109. In addition to the requirements on disclosure and presentation of credit ratings, the CRA Regulation imposes a number of prescriptive disclosure requirements on CRAs in relation to their organisation and their activities, including the methodologies they use for determining and publishing credit ratings.

110. ESMA considers that the objectives of the general and periodic disclosure requirements of the CRA Regulation are aimed at ensuring transparency about credit rating activities, at making information available to the public to allow it to perform an assessment on

whether to rely on certain credit ratings as well as at providing information to competent authorities for the purposes of on-going supervision.

111. For the purpose of this Methodological Framework, a distinction is made between:

(a) General additional disclosure requirements; and

(b) Periodic additional disclosure requirements, which include the information expected to be provided in the transparency reports.

6.2.1 General additional disclosure requirements

112. According to Article 11(1) and Part I of Section E of Annex I of the CRA Regulation, a CRA is required to generally disclose to the public the following information:

(a) the fact that it is registered;

(b) a list of ancillary services;

(c) the policy of the CRA concerning the publication of credit ratings and other related communications;

(d) the general nature of its compensation arrangements;

(e) the methodologies, and descriptions of models and key rating assumptions as well as their material changes;

(f) any material modification to its systems, resources or procedures; and

(g) where relevant, its code of conduct.

113. ESMA recognises the importance of the disclosure of such information for the purposes of achieving the objectives referred to in paragraph 110 above. ESMA considers that it is necessary to assess, whether or not as a minimum, the information referred to under letters a), b), c), e), g) of paragraph 112 above is disclosed to the public. ESMA can accept that the information referred to under letters d) and f) of paragraph 112 above is provided only to the competent authority.

6.2.2 Periodic Additional disclosure requirements

114. Article 11(3) and paragraph (2) of Part II of Section E of Annex I of the CRA Regulation require CRAs to provide, on an annual basis, to the competent authority:

(a) list of fees charged to each client for individual credit ratings and any ancillary services;

(b) a list of the clients whose contribution to the growth rate in the generation of the CRA's revenue in the previous financial year exceeded the growth rate in the total revenue of the CRA in that year by a factor of 1.5 times; and

(c) the pricing policy, including the fees structure and pricing criteria in relation to credit ratings for different asset classes.

115. ESMA expects the third-country legal and supervisory framework to impose some form of disclosure requirement regarding revenue generation by the CRA and that the third-country supervisor has the power to request all the information listed above.

116. In addition to these requirements, Article 11(2) and paragraph (1) of Part II of Section E Annex I of the CRA Regulation requires CRAs to make available to the public, on a half-yearly basis, data about the historical default rates of their rating categories, distinguishing between geographical areas of the issuers and whether these default rates have changed over time.

117. ESMA considers that the third country legal and regulatory framework shall require CRAs to disclose to the public data about historical default rates of rating categories and their changes over time. However, ESMA can accept that the frequency for publication may be different, as well as that no distinction is made between the geographical areas of the issuer.

118. In addition, under Article 12 and Part III of Section E of Annex I of the CRA Regulation, CRAs are required to make the following information available to the public on an annual basis in an annual report on their internet website:

(a) a detailed description of their legal structure, ownership and revenue streams;

(b) a description of the internal control mechanisms ensuring quality of their credit rating activities;

(c) a description of their record keeping policy;

(d) a description of their management and rotation policy;

(e) statistics on the allocation of their staff to new credit ratings, credit rating reviews, methodologies or model appraisals and senior management, and on the allocation of staff to rating activities with regard to the different asset classes (corporate — structured finance — sovereign);

(f) the outcome of the annual internal review of their independent compliance function; and

(g) financial information on the revenue of the credit rating agency, including total turnover, divided into fees from credit rating and ancillary services with a comprehensive description of each, including the revenues generated from ancillary services provided to clients of credit rating services and the allocation of fees to credit ratings of different asset classes. Information on total turnover shall also include a geographical allocation of that turnover to revenues generated in the Union and revenues worldwide.

119. Whilst according to the CRA Regulation these requirements need to be disclosed to the public, ESMA considers disclosure to the authority is adequate. In addition, ESMA

considers that it can accept that CRAs are not required to disclose the statistics referred to under letter e) in paragraph 118 above. The level of detail concerning the disclosures mentioned in letter g) do not need to be identical to the EU requirements.

7 Effective supervision and enforcement

120. Article 5(6)(a) of the CRA Regulation include as preconditions for certification that CRAs in the third country are subject to effective supervision and enforcement on an ongoing basis (Article 5(6)(a)). In addition, the coordination arrangements that need to be in place in accordance with Article 5(7) of the CRA Regulation have to include provisions relating to the "coordination of supervisory activities…".

121. The following provides a fixed set of criteria for assessing a third-country supervisory regime. In assessing the nature of a third-country supervisory framework, ESMA divided the requirements into the following areas:

    I) the methods that the authority has in place to ensure that it is adequately staffed;

    II) the powers of the relevant authority; and

    III) the nature of the penalties that can be imposed.

122. ESMA points out that it does not make any judgments regarding the approach that the third country regulator adopts in relation to on-going supervision, for example, whether a risk-based approach is a good or bad thing, but is overall looking to get comfort that the supervision that will or is being done can be or is in practice effective.

7.1 The methods that the third-country authority has in place to ensure that it is adequately staffed

123. The nature of supervision and enforcement that takes place in respect of monitoring and supervising the CRAs' adherence to their obligations and taking action where they do not, is heavily dependent upon the number of staff that the relevant authority charged with the legal responsibility of supervising these entities has in place.

124. Article 22(2) of the CRA Regulation requires that competent authorities in the EU be adequately staffed, with regard to capacity and expertise, in order to able to apply the CRA Regulation.

125. ESMA does not expect to find a similar legal provision but ESMA does expect that there will be an adequate number of staff.

126. In the EU there is no standardisation of what "adequate" means and the minimum number of staff or their expertise for the purposes of applying the CRA Regulation, as such there is no benchmark against which ESMA can assess a third-country supervisor for the purposes of equivalence.

127. However, without the necessary staff there cannot be “effective supervision”, as such, ESMA has sought to understand how the regulator in question either already does, or will, in the future be organising itself, and how many staff it has or will have.

128. ESMA is conscious of the fact that this is an area that may change in respect of the third country that it is assessing, but clearly if there is no thought to how supervision will in practice be carried out – then irrespective of the powers that the supervisors may have at its disposable to use, ESMA cannot say that the supervision is or will be effective.

7.2 The powers of the relevant authority

129. Articles 23b-23d of the CRA Regulation sets out the details of the powers ESMA has order to be able to discharge its legal duties under CRA Regulation.

130. The necessary powers that the authority need to have are the power to:

(a) access to any document in any form and to receive or take a copy thereof;

(b) demand information from any person and if necessary to summon and question a person with a view to obtaining information;

(c) carry out on-site inspections with or without announcement; and

(d) require records of telephone and data traffic.

131. In addition, as set out in Article 24 of the CRA Regulation, the authority in question has to be able to take the following measures against a CRA following the establishment of a breach by it in respect of its obligations under the CRA Regulation:

(a) to withdraw the CRA’s registration or authorisation;

(b) to prohibit the CRA from temporarily issuing credit ratings;

(c) to suspend the use of credit ratings issued by the CRA for regulatory purposes;

(d) to take appropriate measures to ensure that the CRA continues to comply with its legal requirements;

(e) to issue public notices where the CRA is in breach of its obligations arising from the relevant regulatory framework in your jurisdiction; and

(f) to refer matters for criminal prosecution to the relevant national authorities.

132. ESMA considers that all the above powers need to be firmly embedded in the relevant law in order to be able to classify the third country regime as having effective supervision which it considers to be equivalent to that of the EU’s.

133. In addition, as set out in the final paragraph of Article 23b(1) of the CRA Regulation the authority needs to be able to exercise these powers in respect of:

“CRAs, persons involved in credit rating activities, rated entities and related third parties, third parties to whom the CRAs have outsourced certain functions or activities; and person otherwise related or connected to CRAs or credit rating activities.”

134. As such ESMA needs to assess not only the nature of the powers that can be exercised, but also against whom these powers can be exercised in assessing whether or not the supervision is or can be “effective.”

7.3 Sanctions

135. Article 36 of the CRA Regulation sets out that the penalties that can be imposed need to be: “effective, proportionate and dissuasive” – but leaves it to each authority to determine what these should be.

136. ESMA expects that the relevant third-country framework has legal provisions setting out what the penalties that can be imposed for breaches of the relevant requirements are, but does not expect these penalties to be published.