



European Securities and
Markets Authority

Consultation Paper

Guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation – supplementary guidance on how to assess if a requirement is “as stringent as” the requirements set out in CRAR



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Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex I. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by 25 May 2018.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

The collection of confidential responses is without prejudice to the scope of Regulation (EC) No 1049/2001. Possible requests for access to documents will be dealt in compliance with the requirements and obligations laid down in Regulation (EC) No 1049/2001.

Data protection

Information on data protection can be found at <https://www.esma.europa.eu/data-protection> under the heading Data Protection.

Who should read this paper

This paper may be of interest to users of credit ratings, credit rating agencies and entities interested in applying to be a registered CRA.

Definitions, legislative references and acronyms

ESMA	European Securities and Markets Authority
The Commission	The European Commission
CP	Consultation paper
CRA Regulation or CRAR	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 3	Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013
ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC
2017 Guidelines	Guidelines on the application of the endorsement regime under Article 4(3) of CRAR (ESMA33-9-205) of November 2017
The Guidelines on Periodic Information	Guidelines on periodic information to be submitted to ESMA by Credit Rating Agencies (ESMA/2015/609) of June 2015
Delegated Regulation on methodologies	Commission Delegated Regulation (EU) No 447/2012 of 21 March 2012 supplementing CRAR by laying down regulatory technical standards for the assessment of compliance of credit rating methodologies
Delegated Regulation on Fees	The European Commission Delegated Regulation (2015/1) of 30 September 2014 supplementing CRAR with regard to regulatory technical standards for the periodic reporting on fees charged by credit rating agencies for the purpose of ongoing supervision by the European Securities and Markets Authority
EU CRA	A credit rating agency registered with ESMA
Endorsing CRA	An EU CRA which endorses or has endorsed one or more credit ratings in accordance with Article 4(3) of the CRA Regulation
Third-country CRA	A CRA which is registered and subject to supervision in a non-EU country or jurisdiction

2 Executive Summary

Reasons for publication

The CRA Regulation (CRAR) allows an EU CRA to endorse a credit rating issued by a third-country CRA if the endorsing CRA can demonstrate that the conduct of the third-country CRA “fulfils requirements which are at least as stringent as” those set out in CRAR.

In November 2017, ESMA published an updated version of its guidelines on the application of the endorsement regime under Article 4(3) of CRAR (hereinafter: “2017 Guidelines”)¹ clarifying that compliance with the third-country legal framework is no longer sufficient to prove that a third-country CRA “fulfils requirements which are at least as stringent as” CRAR. Instead, ESMA expects that the endorsing CRA has verified and is able to demonstrate that the third-country CRA has established internal requirements which are at least as stringent as the corresponding requirements in the relevant endorsement provisions of CRAR. In this regard and to be eligible for endorsement, a third-country CRA has two options: a) it can either fulfil the requirements set out in the relevant endorsement provisions of CRAR; or b) it can establish internal requirements which are different but at least as stringent as the relevant endorsement provisions of CRAR; if a third-country CRA chooses the latter, it should be able to demonstrate to ESMA that the different requirement is at least as stringent as the corresponding EU requirements.

During the consultation phase for the 2017 Guidelines, CRAs expressed a demand for supplementary guidance to assess whether internal requirements currently in place in third-country CRAs could be considered as stringent as those set out in the relevant endorsement provisions of CRAR. The supplementary guidance proposed in this CP aims to provide clarity regarding the general principle ESMA relies on when assessing whether an alternative internal requirement can be considered as stringent as a requirement set out in CRAR. Furthermore, the proposed guidance intends to provide transparency and certainty with regard to those areas where third-country CRAs are not already fulfilling the EU requirements. The CP proposes to add the proposed supplementary guidance as a new section of the 2017 Guidelines.

Contents

Section 3 of the CP provides a background to the proposed supplementary guidance summarising key changes introduced by the 2017 Guidelines. Section 4 provides ESMA’s view on every requirement for which an EU CRA has provided a detailed outline of, and justification for, a current divergence in the policies and procedures applied inside and outside the EU.

Annex II contains the 2017 Guidelines along with the proposed supplementary guidance in section 5.3 “Requirements which ESMA considers at least as stringent as those set out in

¹ ESMA first published the Guidelines on the application of the endorsement regime under Article 4(3) of CRAR in May 2011 (reference: ESMA/2011/139). The 2017 Guidelines (reference number: ESMA33-9-205) are an updated version of the Guidelines published in 2011. The 2017 Guidelines will apply to credit ratings issued on or after 1 January 2019 and to existing credit ratings reviewed after that date.

Articles 6-12 and Annex I of CRAR". The proposed new text is provided in blue to distinguish it from the existing text.

Next steps

The consultation will be open for 8 weeks. ESMA will consider the feedback it receives to the consultation with a view to publish a consolidated version of the Guidelines on Endorsement including the proposed new section 5.3 in Q3 of 2018. The proposed supplementary guidance will, like the 2017 Guidelines, apply to credit ratings issued on or after 1 January 2019 and to existing credit ratings reviewed after that date.

3 Background

1. On 17 of November 2017, ESMA published its updated Guidelines on the application of the endorsement regime under Article 4(3) of CRAR² (hereinafter: 2017 Guidelines). The 2017 Guidelines set out ESMA's expectations for CRAs who endorse credit ratings (hereinafter: "endorsing CRA") providing ESMA's view of:
 - a. the notion of "objective reasons" (Article 4(3)(e));
 - b. ESMA's supervisory powers as regards endorsed credit ratings (Article 4(3)(c)-(d)); and
 - c. the evidence an endorsing CRA should provide to be able to demonstrate to ESMA that the conduct of the third-country CRA fulfils requirements which are at least "as stringent as" 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 (hereinafter: "the relevant endorsement provisions of CRAR") (Article 4(3)(b)).
2. More specifically, with regard to Article 4(3)(b), the 2017 Guidelines clarified that ESMA considers that compliance of a third-country CRA with the third-country legal and supervisory framework does not in and of itself prove that the third-country CRA is fulfilling requirements which are "as stringent as" the requirements set out in the relevant endorsement provisions of CRAR. Instead, ESMA expects that the endorsing CRA is able to demonstrate one of two things:
 - a. that the third-country CRA fulfils the requirements set out in the relevant endorsement provisions of CRAR; or
 - b. that the third-country CRA has established alternative internal requirements which are at least as stringent as the relevant endorsement provisions of CRAR. If a third-country CRA chooses the latter, the endorsing CRA should be able to demonstrate to ESMA that the different requirement is at least as stringent as the EU requirements.
3. Further to this, paragraphs 13-14 of the 2017 Guidelines set out how to fulfil the requirements described above, namely, that an endorsing CRA should undertake an assessment of the relevant policies and procedures in the third-country CRA as well as any subsequent material changes thereto. In addition, the endorsing CRA should be able to demonstrate to ESMA that the conduct of the third-country CRA adheres to these policies and procedures in practice. The 2017 Guidelines proposed that the latter is achieved, for example, through automated checks, periodic deep dive assessments of the compliance of a sample of endorsed credit ratings with specific requirements or areas of requirements and/or review of documentation produced by the key control functions of the third-country CRA.

² Reference number: ESMA33-9-205

4. During the consultation phase of the 2017 Guidelines, CRAs currently endorsing credit ratings expressed a demand for supplementary guidance to help them assess whether the internal requirements in place in third-country CRAs could be considered as stringent as those set out in the relevant endorsement provisions of CRAR.
5. To this end, ESMA sent a letter to all registered CRAs with outstanding endorsed credit ratings. The letter invited the CRAs to provide a list of the relevant endorsement provisions of CRAR, which third-country CRAs currently do not comply with in the same way as the EU CRA of the same group does. Furthermore, ESMA invited the CRAs to indicate the alternative internal requirements which had been put in place as well as a justification for why ESMA should consider the different requirements established by third-country CRAs to be as stringent as the requirements set out in the relevant endorsement provisions of CRAR.
6. ESMA received responses from all CRAs which are currently endorsing credit ratings. Many responses focused on third-country CRAs based in the United States, since a large proportion of endorsed ratings are issued in that jurisdiction. Based on the information provided in these responses, ESMA proposes with this CP to provide supplementary guidance to CRAs by adding a new subsection to the 2017 Guidelines. ESMA encourages all registered CRAs to provide their views to this CP should they wish to benefit from the endorsement regime in the future.
7. ESMA intends to provide additional guidance on the application of Article 4(3)(c) when it will update its Guidelines on Periodic Information in Q4 of 2018³.

3.1 The objective and scope of the proposed supplementary guidance

8. The aim of the proposed supplementary guidance is not to provide an exhaustive list of requirements which are as stringent as each requirement set out in the relevant endorsement provisions of CRAR. Instead, the aim of the CP is twofold:
 - a. to clarify the general principle for assessing whether a requirement is “as stringent as”; and
 - b. to provide an assessment of a set of concrete requirements based on information provided by CRAs.

The general principle for assessing whether a requirement is “as stringent as”

9. This supplementary guidance should provide clarity regarding the general principle ESMA relies on when assessing whether an alternative internal requirement can be considered as stringent as a requirement set out in CRAR within the meaning of Article 4(3)(b). This principle is provided in recital 13 of CRA 1 which states that an alternative requirement can

³ Guidelines on periodic information to be submitted to ESMA by Credit Rating Agencies (ESMA/2015/609) of June 2015

be deemed to be “as stringent as” when it achieves the same objective and effects in practice as the corresponding requirement of CRAR.

10. In this respect it is also important to reiterate how the notion of “as stringent as” relates to the notion of “equivalence”, in other words, how this supplementary guidance relates to ESMA’s methodological framework for assessing a third-country legal and supervisory framework for the purpose of endorsement⁴ (MF for endorsement) and equivalence⁵ (MF for equivalence).
11. As set out in in paragraph 27 of the feedback statement of the 2017 Guidelines, the purpose of the MFs for endorsement and equivalence “is solely to provide clarity as to how ESMA performs the assessment of a third-country’s legal and supervisory framework, and should not be relied upon for the purpose of assessing the conduct of a third-country CRA pursuant Article 4(3)(b) of CRAR. [...] The requirement in Article 4(3)(b) relates to the conduct and internal requirements of a third-country CRA and is separate and in addition to the requirements to the legal and supervisory framework of a third country. To meet the requirement in Article 4(3)(b), the endorsing CRA should verify that the third-country CRA, in addition to meeting the local regulatory requirements, fulfils the requirements set out in the relevant endorsement provisions of CRAR or has implemented and adheres to (different) internal requirements which are at least as stringent.”
12. The relationship between the MF for endorsement, the MF for equivalence and the supplementary guidance proposed in this CP is summarised in the table below.

	Assessment of...	Available in...	Legal basis
Endorsement MF	...a third-country legal and supervisory framework.	...Annex II of 2017 Guidelines.	Article 4(3)(f)-(h)
Equivalence MF		... Annex III of TA on Equivalence ⁶ .	Article 5(6)
Requirements which are at least as stringent as those set out in CRAR	...the conduct and internal requirements of a third-country CRA.	...the proposed supplementary guidance of this CP.	Article 4(3)(b)

An assessment of a set of concrete cases provided by CRAs

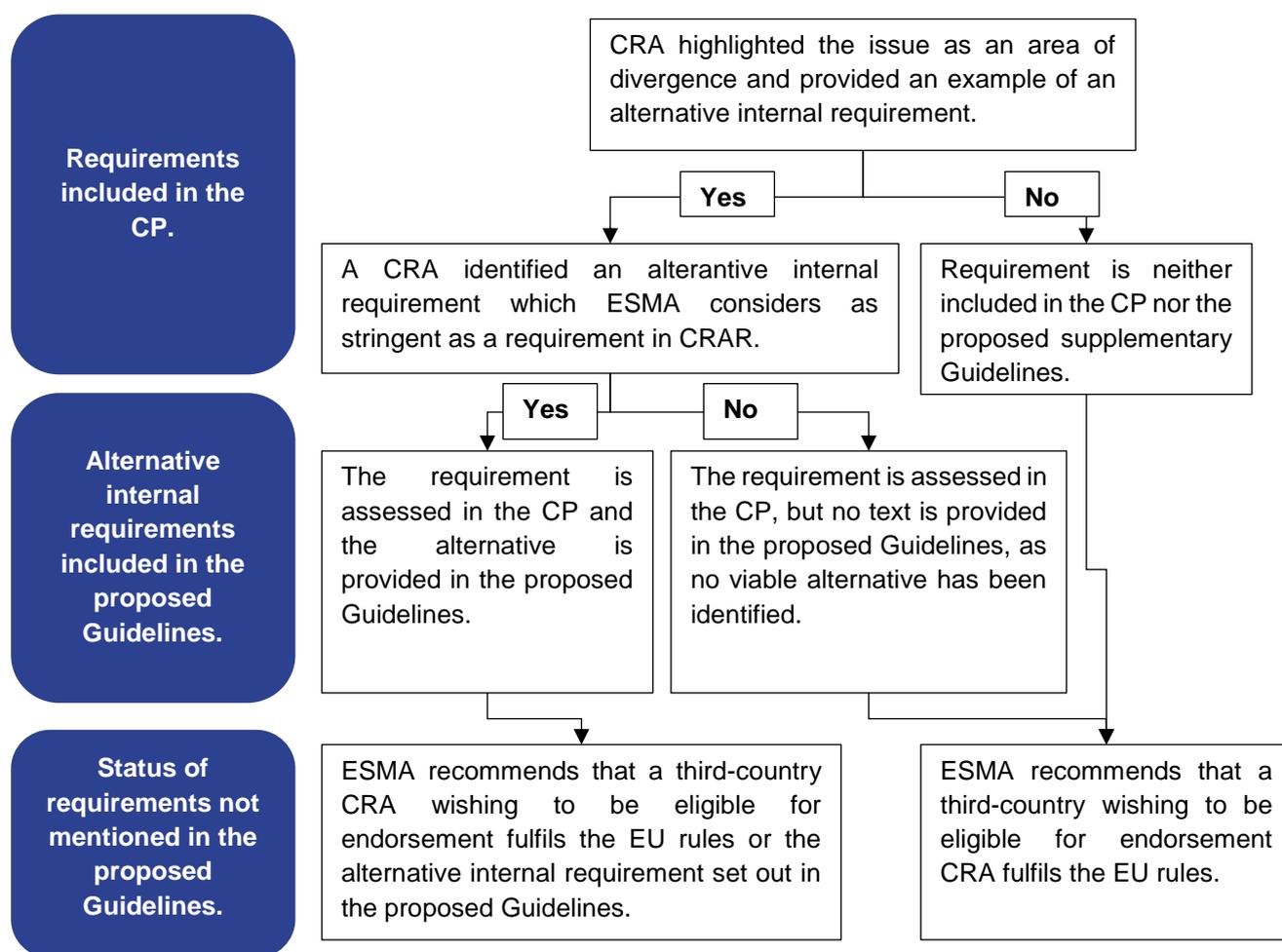
13. The supplementary guidance aims to provide transparency and certainty with regard to those areas where CRAs have provided ESMA with concrete cases of diverging policies and procedures within and outside the EU. Areas where CRAs did not provide a detailed outline of, and a justification for, current divergence have not been addressed in this CP and consequently not included in the proposed new section of the Guidelines.

⁴ Published in Annex III of the 2017 Guidelines.

⁵ Published in Annex III of ESMA’s “Technical Advice to the European Commission on Equivalence” of 17 November 2017, Reference number: ESMA33-9-207.

⁶ “Technical Advice to the European Commission on Equivalence” of 17 November 2017, Reference number: ESMA33-9-207.

14. Of the requirements discussed in this CP, only those for which a viable alternative internal requirement was identified have been included in the Guidelines. The Guidelines are silent on the areas where ESMA does not consider that a CRA has identified an alternative internal requirement which is as stringent as the corresponding requirement in CRAR.
15. Where no alternative internal requirement is provided in these Guidelines, ESMA recommends that the endorsing CRA ensures that the third-country CRA directly fulfils the requirements set out in the relevant endorsement provisions of CRAR.
16. The figure below summarises how ESMA determined whether a requirement should be included in the CP, and if yes, whether to include it in the proposed supplementary guidance. The figure also indicates the status of requirements which are not addressed in the proposed supplementary guidance.



4 Proposed updated Guidelines on Endorsement

17. This section provides ESMA's view on each area for which ESMA has been informed that there may be a divergence in the policies and procedures applied inside and outside the EU. Each requirement or group of requirements is analysed in its own subsection, and each subsection follows the same structure:
- a. first, the subsection sets out the EU requirement as well as the underlying objective of the requirement as set out in the recital(s) of CRAR;
 - b. second, the subsection presents the alternative internal requirement(s) established by one or more third-country CRAs; and
 - c. third, the subsection provides ESMA's view as to whether the alternative internal requirement established by the third-country CRA can be considered "as stringent as" the requirement set out in CRAR. If this is the case, this is included in the proposed Guidelines. Where ESMA does not consider that CRAs have identified alternative internal requirements which are as stringent as the requirements laid down CRAR, the area is not included in the proposed Guidelines.
18. The requirements are grouped into areas which share common traits:
- a. Requirements relating to fees charged by CRAs.
 - b. Requirements to accompany the disclosure of a credit rating with certain information.
 - c. Other disclosure requirements.
 - d. Requirements regarding the review and disclosure of methodologies.
 - e. Requirements regarding independence and conflicts of interest.
 - f. Requirements regarding the treatment of information relating to a credit rating prior to publication.

4.1 Requirements relating to fees charged by CRAs

19. This section focuses on the requirement that fees charged by CRAs to their clients should be cost-based and non-discriminatory and that CRAs' fees and pricing documents should be disclosed to ESMA annually. The objective of these requirements is to mitigate conflicts of interest and facilitate fair competition in the credit rating industry and allow ESMA to effectively supervise CRAs' compliance with the provisions of the CRA regulation.

4.1.1 Fees charged to be non-discriminatory and based on actual costs

20. CRAR contains a requirement for a CRA to 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:

Paragraph 3c of Section B of Annex I. 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 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.

21. **Objective(s) of the requirement(s):** The objective of this requirement is laid down in recital 38 of CRA 3. The requirement aims to mitigate conflicts of interest and facilitate fair competition in the credit rating industry. Differences in fees charged for the same type of service should only be justifiable by a difference in the actual costs in providing this service to different clients. Moreover, the fees charged for credit rating services to a given issuer should not depend on the results or outcome of the work performed or on the provision of related (ancillary) services.

22. **CRA comments:** CRAs indicated that they do not follow the same procedure with regard to this requirement inside and outside the EU. However, CRAs also indicated having separate policies which achieve the same objectives. One CRA has a global policy aimed at preventing rating outcomes from being linked to fees. It also has controls in place to prevent analysts from engaging in commercial discussions or becoming aware of fees charged to clients. With respect to costs, one CRA argues, given that a CRA manages its business to achieve certain margins, it is, by definition, setting fees in relation to its overall costs. With respect to non-discrimination, the CRA outlined that it applies its pricing policy related to granting of discounts on a global basis. The main reasons provided by CRAs for applying a different policy inside and outside the EU are the following:

- Global outlier requirement: The requirement that fees charged by a CRA to its clients are not discriminatory and “based on actual costs” is unique to the EU CRA Regulation. The EU is an outlier in terms of attempting to implement pricing regulation of the CRA sector.
- Costly to implement: Mandating this requirement in third country jurisdictions would be onerous to implement. It would be burdensome and potentially create significant

challenges and costs without apparent benefit, including if the third-country CRA's fees and pricing policies were to be reported to ESMA on an annual basis.

- o Potential conflict of law: Interference in the fee structure of CRAs abroad by ESMA, may contradict local regulatory requirements.

23. **ESMA's view**: ESMA recognises that it is currently the only jurisdiction with legislation in place to determine how fees should be charged for credit ratings and ancillary services. However, the overall objectives of these provisions, to mitigate conflicts of interest and foster fair competition in the CRA industry, are present in the legislation in force in many other jurisdictions. As such, ESMA believes that CRAs should already be monitoring the fees that they charge and ensuring that they achieve these objectives. As CRAs have not identified alternative internal requirements, ESMA recommends that endorsing CRAs should ensure that the third-country CRA fulfils the EU rules.

24. ESMA has recently published a Thematic Report on Fees charged by Credit Rating Agencies and Trade Repositories, which clarifies how ESMA expects CRAs to interpret the requirements of Paragraph 3c of Section B of Annex I of CRAR.

Text of proposed guidelines
No text.

Question for Respondents

Q1. Do you agree with ESMA's view in respect of this provision?

4.1.2 Reporting of fees data and pricing policy

25. CRAR contains a set of requirements for CRAs to disclose periodic information to ESMA regarding the fees it charges for credit ratings and ancillary services offered by the CRA.

Article 11(3): A credit rating agency shall provide annually, by 31 March, to ESMA information relating to matters set out in point 2 of Part II of Section E of Annex I.

Point 2 of Part II of Section E of Annex I: Disclosures

[...]

II. Periodic disclosures

A credit rating agency shall periodically disclose the following

[...]

2. annually, the following information:

(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;

[...]

The European Commission Delegated Regulation (2015/1) of 30 September 2014 supplementing CRAR with regard to regulatory technical standards for the periodic reporting on fees charged by credit rating agencies for the purpose of ongoing supervision by the European Securities and Markets Authority (hereinafter: “the Delegated Regulation on Fees”).

26. **Objective(s) of the requirement(s):** Recital 38 of CRA 3 provides that, in order to allow for the effective supervision of the requirement that fees charged by CRAs to their clients shall be cost-based and non-discriminatory (as discussed in the previous subsection), CRAs should disclose to ESMA the fees received from each of their clients and their general pricing policy. The aim of the requirement to report the fees charged by CRAs to ESMA is to further mitigate conflicts of interest and facilitate fair competition in the credit rating industry.
27. **Comments from CRAs:** CRAs have indicated that the imposition of EU requirements on third-country CRAs would be unnecessarily burdensome and that doing so could create significant challenges and costs without apparent benefit. This would, according to one CRA potentially require data management resources and IT system changes to operationalise the submission of the relevant data to ESMA in respect of a wider range of ratings.
28. **ESMA’s position:** ESMA considers that the objective of this reporting requirement, i.e. to enable ESMA to undertake effective supervision of requirement relating to fees and to monitor potential conflicts of interests, would not be achieved, if the third-country CRA reported the information set out in these provisions solely to its local supervisor. In order to achieve the objective underlying these provisions the relevant information would need to be reported to ESMA.
29. EU registered CRAs report the information set out in these provisions through a dedicated reporting system, RADAR, in accordance with the Delegated Regulation on Fees. ESMA believes that an endorsing CRA should be allowed to report the information set out in these provisions in respect of endorsed credit ratings and related ancillary services in the same way. This may reduce the reporting costs by avoiding the need for the third-country CRA to establish direct reporting and independent channels to ESMA.
30. For endorsed credit ratings and related ancillary services, ESMA considers that a CRA may choose to submit to ESMA the list of deviations from fee policies, schedules, programmes and procedures which is recorded pursuant to Article 3(3) of the Delegated Regulation on Fees instead of reporting to ESMA the fee schedules, fee programmes and pricing procedures in accordance with Article 2 and Tables 2-4 of Annex I of the Delegated Regulation on Fees. In this way, ESMA believes that the reporting burden relating to

endorsed credit ratings and related ancillary services could be reduced, while still ensuring the ability to achieve its underlying objective.

Text of proposed guidelines

ESMA considers that the endorsing CRA has demonstrated to ESMA that the conduct of the credit rating activities by the third-country CRA resulting in the issuing of an endorsed credit rating fulfils requirements which are at least as stringent as those set out in CRAR, where the endorsing CRA reports the information set out in these provisions to ESMA for a credit rating it has endorsed and related ancillary services in accordance with the Delegated Regulation on Fees.

In place of reporting the fee schedules, fee programmes and pricing procedures in accordance with Article 2 and tables 2-4 of Annex I of the Delegated Regulation on Fees, the endorsing CRA may choose to submit to ESMA a list of all deviations from its pricing policies or pricing procedures, or the non-application of a pricing policy, fee schedule or fee programme, or pricing procedure with a clear identification of the main explanations for the deviation which are to be recorded in accordance with Article 3(3) of the Delegated Regulation on Fees.

Question for Respondents

Q2. Do you agree with the proposed guidelines in respect of this provision?

4.2 Requirements to accompany the disclosure of a credit rating with certain information

31. This section focuses on requirements on CRAs to accompany the disclosure of a credit rating with certain information. The objective of these requirements is to protect EU investors through increased transparency about the nature, risks and quality of individual credit ratings.

4.2.1 Disclosures relating to ratings of structured finance instruments

32. CRAR contains a range of disclosure requirements which are specific to structured finance instruments:

Article 10(3): When a credit rating agency issues credit ratings for structured finance instruments, it shall ensure that rating categories that are attributed to structured finance instruments are clearly differentiated using an additional symbol which distinguishes them from rating categories used for any other entities, financial instruments or financial obligations.

33. **Objective(s) of the requirement(s):** The objective of these requirements is laid down in recital 40 of CRA 1 and Recital 30 of CRA 3. Under certain circumstances, structured finance instruments may have effects which are different from traditional corporate debt instruments. It could be misleading for investors to apply the same rating categories to both types of instruments without further explanation. CRAs should play an important role in raising awareness of the users of credit ratings about the specificities of the structured finance products in relation to traditional ones. CRAs should therefore clearly differentiate between rating categories used for rating structured finance instruments on the one hand, and rating categories used for other financial instruments or financial obligations on the other, by adding an appropriate symbol to the rating category. Furthermore, the ability of investors to make an informed assessment of the creditworthiness of structured finance instruments would be improved if investors were provided with sufficient information on those instruments. For example, as the risk on structured finance instruments to a large extent depends on the quality and performance of the underlying assets, investors should be provided with more information on the underlying assets. This would reduce investors' dependence on credit ratings.

34. **Comments from CRAs:** One CRA has indicated that each of its subsidiaries follows requirements for disclosures as stipulated by national law and/or regulation. In some instances, there may be a high correlation between local requirements and EU requirements.

35. **ESMA's position:** ESMA does not consider that CRAs have identified alternative internal requirements which are as stringent as the requirements laid down in Articles 10(3) of CRAR. It could create confusion if the same disclosure for two different credit ratings issued by the same CRA (one of them having been endorsed) related to different definitions of a structured finance instrument. ESMA does not consider that the objective of this requirement can be achieved if the definition of a structured finance instrument

underpinning the disclosure is not the one laid down in Article 4(1)(61) of Regulation (EU) No 575/2013. In the absence of alternatives, ESMA recommends that endorsing CRAs ensure that the third-country CRA fulfils the EU rules.

Text of proposed guidelines
No text.

Question for Respondents

Q3. Do you agree with ESMA's view in respect of this provision?

4.2.2 Disclosures relating to the solicitation status of a credit rating

36. CRAR contains a range of disclosure requirements relating to the solicitation and participation status of a credit rating:

Article 10(5): Where a credit rating agency issues an unsolicited credit rating, it shall state prominently in the credit rating, using a clearly distinguishable different colour code for the rating category, whether or not the rated entity or a related third party participated in the credit rating process and whether the credit rating agency had access to the accounts, management and other relevant internal documents for the rated entity or a related third party.

Unsolicited credit ratings shall be identified as such.

37. **Objective(s) of the requirement(s):** The objective of these requirements is laid down in recital (21) of CRA 1: An unsolicited credit rating should be clearly identified as such and should be distinguished from solicited credit ratings by appropriate means. The relationship between the CRA and a rated entity as well as the extent to which a CRA has access to the accounts, management and other relevant internal documents for the rated entity are valuable pieces of information for an investor intending to use a credit rating.

38. **Comments from CRAs:** CRAs have indicated relying on local policies for the fulfilment of this requirement outside the EU. One CRA does not implement the EU standard globally and states that operationalising the EU standard globally could be challenging given the differences between jurisdictions relating to the applicable definition of solicitation status.

39. Another CRA focuses on a separate but related requirement applicable exclusively to non-solicited ratings. This requirement obliges a CRA to indicate, using a clearly distinguishable colour code, whether the rated entity participated in the credit rating process and whether the CRA had access to the accounts, management and other relevant internal documents for the rated entity. The CRA notes that in recent publications both the EC and ESMA have recognised the significance of unsolicited ratings to support competition. It is the CRA's policy that it will not issue or maintain an unsolicited rating unless it has sufficient information, as required under its applicable methodologies. The CRA believes that using

the same colour for non-participation unsolicited ratings does not mean that its third-country CRA and its affiliates are operating in any way less stringently than those in the EU. Using the same colour also avoids a possible perception that these ratings might be seen as being of a lower quality - which the CRA considers would have a negative effect on competition.

40. **ESMA's position:** With regard to the requirement to disclose a credit rating as unsolicited using the definition provided in CRAR, ESMA does not consider that CRAs have identified alternative internal requirements which are "as stringent as". It could create confusion if the same disclosure for two different credit ratings issued by the same CRA (one of them having been endorsed the other issued in the EU) related to different definitions of solicitation. ESMA does not consider that the objective of this requirement can be achieved if the applicable definition of a solicitation underpinning the disclosure is not the one laid down in CRAR. In the absence of alternatives, ESMA recommends that endorsing CRAs ensure that the third-country CRA fulfils the EU rules with respect to endorsed credit ratings.
41. With regard to the requirement to disclose participation of the rated entity in an unsolicited rating using a colour code, ESMA considers that the objective underpinning the requirement can be achieved by other means. What is important is that the information is transmitted clearly to the rating user.

Proposed CP text

ESMA considers that the disclosure of participation status without using a colour code can be considered as stringent as the requirement to disclose participation status using a colour code, if the illustration of participation status is equally prominent.

Question for Respondents

Q4. Do you agree with the proposed guidelines in respect of these provisions?

4.3 Other disclosure requirements

42. The following section concerns disclosure requirements other than those required to accompany the publication of a credit rating or a rating outlook.

4.3.1 Disclosures to be made in the transparency report

43. CRAR requires a range of information to be published by a CRA in its annual “transparency report”.

Article 12 Transparency report

A credit rating agency shall publish annually a transparency report which includes information on matters set out in Part III of Section E of Annex I. The credit rating agency shall publish its transparency report at the latest three months after the end of each financial year and shall ensure that it remains available on the website of the agency for at least five years

Part III of Section E of Annex I

III. Transparency report a credit rating agency shall make available annually the following information:

1. detailed information on legal structure and ownership of the credit rating agency, including information on holdings within the meaning of Articles 9 and 10 of Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (1);
2. a description of the internal control mechanisms ensuring quality of its credit rating activities;
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);
4. a description of its record-keeping policy;
5. the outcome of the annual internal review of its independent compliance function;
6. a description of its management and rating analyst rotation policy;
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;

8. a governance statement within the meaning of Article 46a(1) of Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies (1). For the purposes of that statement, the information referred to in Article 46a(1)(d) of that Directive shall be provided by the credit rating agency irrespective of whether it is subject to Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (2).

44. **Objective(s) of the requirement(s):** The objective of this requirement is to ensure investor protection through transparency on the internal structure, processes and policies of a CRA.
45. **CRA comments:** CRAs indicated that relying on different policies in third-countries for complying with this requirement. One CRA stated that US CRAs are required to annually publish an updated “Form NRSRO” and while there are differences in detail between this report and a transparency report, the objectives are the same.
46. **ESMA’s view:** In all jurisdictions for which endorsement is possible, CRAs are required to disclose periodically some transparency information. It would not contribute to achieving the objective of transparency and protection of EU investors if each third-country CRA complemented its local equivalent to the annual EU transparency report with information required under Article 12 of CRAR. This would only make it more difficult for an EU investor to piece together the relevant information. Furthermore, the information provided in a third-country annual report might not be easily accessible to EU investors in practice due to language differences. However, it is important that the transparency report published by the endorsing CRA takes into account endorsed credit ratings.

Text of proposed guidelines

ESMA considers that the endorsing CRA has demonstrated to ESMA that the conduct of the credit rating activities by the third-country CRA resulting in the issuing of an endorsed credit rating fulfils requirements which are as stringent as those set out in these provisions, where the endorsing CRA includes information about the endorsed credit ratings in its own transparency report, specifically:

- the description of the internal control mechanisms ensuring quality of a CRA’s credit rating activities should include control mechanisms applicable to endorsed credit ratings;
- the outcome of the annual internal review of a CRA’s independent compliance function should take into account the compliance of endorsed credit ratings;
- the description of the policy for record-keeping and analyst rotation should indicate whether such policies are global or only applied to EU ratings; and
- the financial information on the revenue of the endorsing CRA, including total turnover and the geographical allocation of that turnover to revenues generated in the Union and revenues worldwide should include information about revenue of the third-country CRA from endorsed ratings.

Question for Respondents

Q5. Do you agree with the proposed guidelines in respect of this provision?

4.3.2 Reporting of initial assessments and preliminary ratings

47. CRAR contains a requirement for a CRA to disclose on its website and notify to ESMA information about entities or debt instruments submitted to it for initial review or for preliminary rating.

Paragraph 6 of Subsection I of Section D of Annex I: 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.

48. **Objective(s) of the requirement(s):** This requirement aims to address the risk of rating shopping through transparency. According to recital 41 of CRA 1, CRAs should take measures to avoid situations where issuers request a preliminary rating assessment from a number of CRAs in order to identify the one offering the best credit rating. Issuers should also avoid applying such practices. This requirement was limited to structured finance instruments prior to the entry into force of CRA 3.
49. **Comments from CRAs:** Two CRAs have indicated they are not required to fulfil this requirement in jurisdictions outside the EU. According to one CRA, it is unclear how this could be enforced, in practice, outside the EU. At the initial stage, it is unlikely to be clear whether an entity wishes to endorse a rating into the EU. Moreover, it is not clear to CRAs how a third-country CRA can comply with the regulatory disclosure requirements when this is not required in its home jurisdiction.
50. According to one CRA, the Rule 17g-5 in the US should be considered as an example of a requirement which could achieve the same objective. This rule requires issuers, underwriters, etc. to disclose information with respect to structured finance transactions to non-hired CRAs, to allow other CRAs to issue non-solicited ratings.
51. **ESMA's position:** ESMA recognises that the objectives of this provision would not be achieved if this requirement were implemented by a subset of third-country CRAs in a certain jurisdiction. Consequently, ESMA is of the view that this requirement often cannot be fulfilled in a meaningful way by a third-country CRA and that other types of safeguards against rating shopping might be as, or more, effective in achieving the objective of addressing the risk of rating shopping. ESMA will assess alternative internal requirements on a case-by-case basis.

Text of proposed guidelines

ESMA considers that internal requirements established by a third-country CRA can be considered as stringent as those set out in these provisions, where they ensure the third-country CRA takes steps to mitigate the risks posed by rating shopping.

Question for Respondents

Q6. Do you agree with the proposed guideline in respect of this provision?

4.4 Requirements regarding the review and disclosure of methodologies

52. The following section concerns requirements relating to the review and disclosure of CRAs' methodologies.

4.4.1 Requirements regarding the review of methodologies

53. CRAR contains a range of requirements relating to the review of methodologies:

Article 8(3): A credit rating agency shall use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing.

Commission Delegated Regulation (EU) No 447/2012 of 21 March 2012 supplementing CRAR by laying down regulatory technical standards for the assessment of compliance of credit rating methodologies (hereinafter: "the Delegated Regulation on Methodologies").

Article 8(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.

Article 8(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.

Article 8(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;

(b) review the affected credit ratings as soon as possible and no later than six months after the change, in the meantime placing those ratings under observation; and

(c) re-rate all credit ratings that have been based on those methodologies, models or key rating assumptions if, following the review, the overall combined effect of the changes affects those credit ratings.

54. **Objective(s) of the requirement(s):** The objective of these requirements is laid down in recitals (23) and (34) of CRA 1 and (27) of CRA 3. The requirements aim to ensure that modifications to rating methodologies do not result in less rigorous methodologies. Consequently, issuers, investors and other interested parties should have the opportunity to comment on any intended change to rating methodologies to help them understand the reasons behind new methodologies and the change in question. The requirement that methodologies are rigorous, systematic, continuous and subject to validation including by appropriate historical experience and back-testing should not provide grounds for interference with the content of credit ratings and methodologies by the competent authorities. The requirement should not be applied in such a way as to prevent new CRAs from entering the market.
55. **CRA comments:** CRAs indicated relying on different policies for the fulfilment of this requirement outside the EU. One CRA stated that ESMA requires more frequent reviews of some methodologies than other jurisdictions. Another CRA noted this difference but indicated that it already applies the EU standard, i.e. annual review, globally. A CRA also indicated that the level of documentation required in the EU is higher than in other jurisdictions.
56. Another CRA indicated that, unlike in other jurisdictions, it is mandatory in the EU to undertake publication and consultation for changes which only affect a single rating. The CRA outlined that it was unclear how the additional burden associated with the EU threshold increases the benefit for investors and issuers. It has been the CRA's experience that investors and issuers do not provide many comments on such drafts. Moreover, if the CRA was required to issue an exposure draft for all criteria which might change one rating only, the CRA believes the material changes would be lost in the increased volume of exposure drafts. The CRA therefore believes the policy applicable to its third-country CRAs and affiliates achieves the requirement for transparency with respect to criteria changes. Finally, the same CRA indicated that it was not applying certain statistical tests in the review of its methodologies in the US.
57. **ESMA's view:** ESMA does not consider that CRAs have identified alternative internal requirements which are as stringent as the requirements laid down in Articles 8(3) (as further specified in the Delegated Regulation on Methodologies and ESMA guidance), (5), (5a) and (6) of CRAR. In the absence of such alternatives, ESMA recommends that endorsing CRAs ensure that the third-country CRA fulfils the EU rules.

Text of proposed guidelines

No text

Question for Respondents

Q7. Do you agree with ESMA’s view in respect of this provision?

4.4.2 Reporting of errors in methodologies

58. CRAR contains a requirement to notify ESMA of errors in methodologies:

Article 8(7)(a): Where a credit rating agency becomes aware of errors in its rating methodologies or in their application it shall immediately:

(a) notify those errors to ESMA and all affected rated entities explaining the impact on its ratings including the need to review issued ratings;

59. **Objective(s) of the requirement(s):** The objective of these requirements is to allow ESMA to keep track of the types and frequency of errors identified by CRAs.

60. **Comments from CRAs:** CRAs indicated that this requirement is not required outside the EU. Two CRAs stated that it would not be sensible to report information to a third-country supervisor which it does not require and potentially cannot use. CRAs also stressed the lack of a “materiality threshold” in the CRAR, which requires even minor errors to be reported to ESMA.

61. **ESMA’s position:** In order to achieve the objective underlying these provisions, i.e. to enable ESMA to keep track of the types and frequency of errors identified by CRAs, the relevant information would need to be reported to ESMA. However, ESMA can accept that either the third-country CRA or the endorsing CRA reports the information set out in these provisions to ESMA. However, ESMA may provide further guidance on the reporting of this information in the EU.

Text of proposed guidelines

ESMA considers that the endorsing CRA has demonstrated to ESMA that the conduct of the credit rating activities by the third-country CRA resulting in the issuing of an endorsed credit rating fulfils requirements which are at least as stringent as those set out in CRAR, where the endorsing CRA reports the information set out in these provisions to ESMA for a credit rating it has endorsed, in the same manner it reports such information for credit ratings issued in the EU.

Question for Respondents

Q8. Do you agree with the proposed guidelines in respect of this provision?

4.5 Requirements regarding independence and conflicts of interest

4.5.1 Rotation of analysts

62. CRAR contains a requirement to rotate lead analysts, rating analysts and persons approving credit ratings:

Article 7(4): A credit rating agency shall establish an appropriate gradual rotation mechanism with regard to the rating analysts and persons approving credit ratings as defined in Section C of Annex I. That rotation mechanism shall be undertaken in phases on the basis of individuals rather than of a complete team.

Paragraph 8 of Section C of Annex I:

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 point.

63. **Objective(s) of the requirement(s):** The objective of the rotation requirement is laid down in recital 33 of CRA 1. The requirement aims to avoid that long-lasting relationships with the same rated entities or their related third parties compromise the independence of rating analysts and persons approving credit ratings. Analysts and persons should therefore be subject to an appropriate rotation mechanism which should provide for a gradual change in analytical teams and credit rating committees.

64. **CRA comments:** CRAs do not undertake rotation of analysts outside the EU using the same policy/procedure as in the EU. One CRA indicates that there is a policy for analyst rotation in Mexico but not in the US and Canada. Another CRA indicates that a global policy requires all its subsidiaries to rotate the primary analyst analytical responsibility over time and in a manner that will promote the continuity of the ratings process. However, the EU rules on analyst rotation are more restrictive and detailed than in most third-country

regimes, in particular regarding the timing of rotation and the type activities that can be performed by analysts during the cool off period.

65. CRAs provide the following arguments against rotation:

- Controversial and inefficient requirement: When rotation was originally introduced in the EU, many market participants (both investors and issuers) argued against rotation. They were concerned that rotation requirements do not take into account the need or specific skill sets when determining ratings (such as language skills, or familiarity with certain complex types of securities).
- Mitigating factors: rotation was introduced to address a possible concern that if an analyst worked for an extended period of time with a given issuer, he or she might be unduly influenced by the relationship when it comes to determining that issuer's rating. However, according to one CRA, no individual analyst is able to determine a rating action alone. All rating actions are decided by well-resourced rating committees that are subject to quorum requirements which are designed to ensure sufficient seniority, expertise and independence. Rating decisions are also subject to internal appeals. Finally, CRAs' analytical independence is further bolstered by the fact that an analyst's compensation is not linked to the amount of revenue that the CRA derives from issuers that this analyst rated or with which this analysts regularly interacts.
- High cost: Some CRAs argue that it would be costly and burdensome to implement EU analyst rotation rules globally and that it would not enhance investor protection or the avoidance and management of conflicts of interests. Aside from costly changes to IT systems and processes, the more restrictive EU rotation rules could potentially create a need to hire additional staff in third-countries with appropriate expertise, including local market and language knowledge.
- Precedence: A CRA notes that the EU rotation requirements have been in place since the initial enactment of the CRAR and that there has never been a corresponding requirement in the certain third-country jurisdictions. Nevertheless, ESMA recognised in its Methodological Framework for assessing equivalence (71)" that analyst rotation is one of the number of ways in which a CRA can achieve the objectives of the management of conflicts of interest requirements".

66. **ESMA's view**: ESMA considers that the objective of this requirement can be met through a different combination of policies and procedures than the one required in CRAR. This may involve different rotation frequency complemented by very robust policies and procedures managing conflicts of interests.

67. Rating analysts and persons approving credit ratings in the third-country CRA may be exempted from the rotation requirements if the endorsing CRA can demonstrate to ESMA that the third-country CRA from which it intends to endorse credit ratings meets the criteria set out in Article 6(3) of CRAR.

Text of proposed guidelines

ESMA considers that internal requirements established by a third-country CRA can be considered as stringent as those set out in these provisions, where they require the third-country CRA to:

- a. record the length of time an analysts or persons approving credit ratings with a single issuer;
- b. ensure that analysts and persons approving credit ratings are subject to an appropriate rotation mechanism which provides for a gradual change in analytical teams and credit rating committees; and
- c. have in place dedicated and robust internal requirements relating to potential conflicts of interest between an analyst and a rated entity.

Question for Respondents

Q9. Do you agree with ESMA's view in respect of this provision?

4.5.2 Conflicts of interests relating to shareholders and directors of CRAs

68. CRAR contains a requirement to identify and manage conflicts of interests relating to shareholders of a CRA:

Article 6(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.

Paragraph 3(aa) and (ca) of Section B of Annex I. 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:

[...]

(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;

[...]

(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;

69. **Objective(s) of the requirement(s):** The objective of these requirements is laid down in recital 20 of CRA 3. The independence of a credit rating agency vis-à-vis a rated entity is also affected by possible conflicts of interest of any of its significant shareholders with the rated entity. A shareholder of a CRA could be a member of the administrative or supervisory board of a rated entity or a related third party. CRA 1 was silent as regards potential conflicts of interest caused by shareholders or members of CRAs. This was addressed in CRA 3 with a view to enhancing the perception of independence of CRAs vis-à-vis the rated entities by extending the existing rules to shareholders or members holding a significant position within the CRA.

70. **CRA comments:** CRAs indicated that they do not follow the same procedure in a third-country with regard to this requirement as the one applied to EU CRAs providing the following reasoning:

- Different threshold under certain third-country laws: In one third country a CRA is prohibited from issuing or maintaining ratings on any entity directly or indirectly controlling, controlled by or under common control with a CRA. EU law adopts a similar approach but uses a lower threshold.
- Strain on the owners of the CRA: These prohibitions place unnecessary constraints on the business activity of the CRA's shareholders.

71. **ESMA's view:** ESMA does not consider that CRAs have identified alternative internal requirements which are as stringent as the requirements laid down in Paragraph 3(aa) and (ca) of Section B of Annex I of CRAR. In the absence of such alternatives, ESMA recommends that endorsing CRAs ensure that the third-country CRA fulfils the EU rules. For outstanding ratings which breach the 10% threshold, it will suffice for the third-country CRA or the endorsing CRA to disclose this along with the rating. A new credit rating breaching this threshold does not meet the conditions for endorsement.

Text of proposed guidelines

No text.

Question for Respondents

Q10. Do you agree with ESMA's view in respect of this provision?

4.5.3 Look-back reviews of analysts leaving a CRA

72. CRAR contains a requirement to review the work of a rating analyst when he or she leaves the CRA:

Paragraphs (6)-(7) of Section C of Annex I: 6. Where a rating analyst terminates his or her employment and joins a rated entity, which he or she has been involved in rating, or a financial firm, with which he or she has had dealings as part of his or her duties at the credit rating agency, the credit rating agency shall review the relevant work of the rating analyst over two years preceding his or her departure.

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.

73. **Objective(s) of the requirement(s):** The objective of this requirements is laid down in recital 27 of CRA 1. CRAs should avoid situations of conflict of interest and manage those conflicts adequately when they are unavoidable in order to ensure their independence. CRAs should disclose conflicts of interest in a timely manner. They should also keep records of all significant threats to the independence of the CRA and that of its employees and other persons involved in the credit rating process, as well as the safeguards applied to mitigate those threats.

74. **CRA comments:** CRAs indicate that they do not follow the same procedure in a third country with regard to this requirement as the one applied to EU CRAs. One CRA explained that the requirement in a third-country jurisdiction is one year rather than two.

75. **ESMA's view:** ESMA does not consider that CRAs have identified alternative internal requirements which are as stringent as the requirements laid down in Paragraphs (6)-(7) of Section C of Annex I of CRAR. In the absence of such alternatives, ESMA recommends that endorsing CRAs ensure that the third-country CRA fulfils the EU rules.

Text of proposed guidelines

No Text.

Question for Respondents

Q11. Do you agree with ESMA's view in respect of this provision?

4.6 Requirements regarding the treatment of information relating to a credit rating prior to publication

4.6.1 24-hour rule

76. CRAR contains a requirement to notify rated entities at least 24 hours before the publication of a credit rating:

Article 10(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.

Paragraph 3 of Subsection I of Section D of Annex I:

3. A credit rating agency shall inform the rated entity during working hours of the rated entity and at least a full working day before the 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.

77. **Objective of the Requirement(s):** The original CRA 1 Regulation required CRAs to provide rated entities with 12 hours to review any credit rating or rating outlook before publication in order to allow the rated entity sufficient time to verify the principal grounds of the credit rating. However, as set out in recital 42 of CRA 3 this provision was seen as insufficient in the event that the credit rating or rating outlook was notified to the rated entity outside of its business hours.

78. As a result, the CRA 3 Regulation revised these notification requirements to ensure the rated entities were guaranteed more time to verify the credit rating or rating outlook and notify the CRA of any factual errors.

79. In practice, this means that a CRA should inform the rated entity during the working hours of the rated entity, and at least 24 hours before the publication of the credit rating or rating outlook. In the event that the rated entity reverts to the CRA before the expiry of the minimum 24 hours, confirming that it has not identified any factual errors in the credit rating or rating outlook, then the CRA may publish the credit rating or rating outlook without further delay

80. **CRA's Comments:** CRAs have not indicated any obstacles to a general implementation of this provision in third countries, however they have identified some issues that may prevent implementation of some specific elements such as length of time for review:

- Conflict with third country legal frameworks: Two CRAs have indicated that where it does not conflict with the third country legal framework, it is their practice to provide the rated entity with a chance to review the rating prior to publication they do so, however these CRAs point out that in these jurisdictions 24 hours may not be possible. In this

regard, one CRA indicates the third country regulator is comfortable with it providing the entity a 12 hour notice period for review.

- Conflict with objectives of market transparency: One CRA highlighted that “pre-publication notice periods” were at odds with the objectives of market transparency and the IOSCO Code. Another CRA highlighted that the 24 hour rule was a unique consequence of the EU sovereign debt crisis and had not been replicated in other jurisdictions where the priority has remained communicating an action to the market as soon as possible.
- Cost of implementation: One CRA highlighted that it would be costly to implement a pre-publication notice period from an IT perspective on a global basis.

81. **ESMA’s view**: ESMA does not consider that CRAs have identified any reasons why they would not be able to provide a reasonable time period for review of a credit rating prior to publication. In terms of the length of time provided for review, ESMA’s preference is for the maximum allowable under that third country’s legal framework up to 24 hours, but can accept less provided that the time allowed is reasonable and the rated entity is notified during its business hours.

Text of proposed guidelines

ESMA considers that internal requirements established by a third-country CRA can be considered as stringent as those set out in these provisions, where they ensure that the third country CRA:

- a. notifies a rated entity about a rating action in advance of publication;
- b. during the business hours of the rated entity; and
- c. provides the rated entity with a reasonable amount of time to provide feedback on any material errors.

Question for Respondents

Q12. Do you agree with ESMA’s view in respect of this provision?

4.6.2 Inside Information

82. CRAR contains a requirement for CRAs to ensure that credit ratings are treated in the same manner as inside information, up until the point of their disclosure:

Article 10(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.

83. **Objective of the Requirement(s):** The CRA Regulation takes a very prescriptive approach to the treatment of credit ratings, rating outlooks and information related thereto. Specifically, that these categories of information are required to be treated in accordance with the requirements for inside information that are set out in the EU Market Abuse Regulation.
84. The effect of this provision is that it ensures the handling of credit ratings is controlled and tracked from an early stage. This achieves two objectives, in the first instance it ensures price sensitive information is tightly controlled, and in the second instance when it is not, there is a record of all individuals who had access to the information setting out when they had access to it etc.
85. For third-country CRAs, the practical consequence of directly implementing this approach is that it requires the effective implementation of the EU regime for the treatment of inside information, but without a supportive and complementary legal framework.
86. **CRAs Comments:** CRA's have provided the following arguments against implementing the insider information provisions in third countries:
- Different concepts or standards for "inside information" within third country legal frameworks: One of the key difficulties involved in replicating this provision outside the EU comes from it's cross-referencing of the concept of "inside information" from the EU Market Abuse Regulation.
 - Data Protection/Confidentiality: CRAs have also raised the issue that the creation of insider lists, and in particular the inclusion of "insiders" from outside of the CRA may raise conflicts with data protection legislation in third countries.
 - High Cost with no tangible benefit for CRAs: CRAs have highlighted that they consider the requirement to create insider lists in third countries to be administratively burdensome which would also provide little benefit to the CRA.
87. One of the main problems with this provision is that in order to directly implement the EU requirements a third country, a CRA would need to implement not just the CRAR provisions, but also MAR and other EU texts such as such as MiFID, from which MAR itself imports a number of definitions. As a result asking for direct implementation of this provision within CRAR may not be feasible for third-country entities.

88. It is also worth noting that if any insider lists were maintained by the third country CRAs, they would almost certainly be out of the supervisory scope of the EU authorities responsible for the supervision of MAR, and may not be applicable or relevant to the supervisory responsibilities of the CRA's own third country supervisor. For ESMA the main value would be as a demonstration that the CRA was adhering to exactly the same internal standards of confidentiality as those in the EU. However, on balance the requirement to maintain insider lists in third countries could be seen as unnecessary.
89. **ESMA's view:** In order to meet the objectives of the EU requirements, it is important that the endorsing CRA ensures that the third country CRA treats its credit ratings, rating outlooks and information related thereto according to that third country regime's requirements for the handling of inside information up until the point of publication/disclosure.

Proposed CP Text

ESMA considers that internal requirements established by a third-country CRA can be considered as stringent as those set out in these provisions, where they ensure that the third-country CRA treats credit ratings, rating outlooks and information related thereto according to that third-country regime's requirements for the handling of inside information up until the point of publication/disclosure.

Question for Respondents

Q13. Do you agree with the proposed guidelines in respect of this provision?

4.6.3 Protection of confidential information

90. CRAR contains a requirement for CRAs to ensure that confidential information is only used for purposes related to credit rating activities and is protected from fraud, theft or misuse.

Article 7(3): A credit rating agency shall ensure that persons referred to in paragraph 1 meet the requirements set out in Section C of Annex I.

Paragraph 3 of Section C of Annex I:

3. Credit rating agencies shall ensure that persons referred to in point 1:

(a) take all reasonable measures to protect property and records in possession of the credit rating agency from fraud, theft or misuse, taking into account the nature, scale and complexity of their business and the nature and range of their credit rating activities;

(b) do not disclose any information about credit ratings or possible future credit ratings of the credit rating agency, except to the rated entity or its related third party;

(c) do not share confidential information entrusted to the credit rating agency with rating analysts and employees of any person directly or indirectly linked to it by control, as well as with any other natural person whose services are placed at the disposal or under the control of any person directly or indirectly linked to it by control, and who is directly involved in the credit rating activities; and

(d) do not use or share confidential information for the purpose of trading financial instruments, or for any other purpose except the conduct of the credit rating activities.

91. **Objective of the Requirement:** The objective of these provisions is set out in recital 22, which states that CRAs should establish, maintain, enforce and document an effective internal control structure governing the implementation of policies and procedures for the prevention and control of possible conflicts of interest and for ensuring the independence of credit ratings, rating analysts and rating teams regarding shareholders, administrative and management bodies and sales and marketing activities.

92. ESMA considers that these requirements are mainly concerned with the policies and procedures the third country CRA has in place governing the conduct of its personnel.

93. **CRAs Comments:** CRAs provided the following arguments against the need for them to implement additional measures in third countries:

- Stringency of confidentiality requirements in US legal framework: In providing their feedback one CRA cited the similarities in stringency within the US and EU regimes when it comes to the protection of confidential information. Specifically, this CRA highlighted that under US law CRAs are required to distinguish between “material non-public information” and other types of confidential information. Under US law, these different categories of information are required to be treated according to different levels of secrecy, with different limitations on circulation applicable to each. This CRA stated that as their internal policies and procedures were complying with these US requirements, there was no need for them to implement additional measures for credit rating activities in third countries to reach the standard of the EU rules.
- Employees subject to the same confidentiality requirements regardless of location: The same CRA outlined that as that CRA’s internal policies and procedures were written to be compliant with US law, which in their view was meeting EU levels of stringency for staff confidentiality rules, and all their employees regardless of location were subject to the same internal policies governing prohibitions on insider trading, there was no need to implement further measures.

94. **ESMA’s view:** ESMA does not consider that CRAs have identified alternative internal requirements which are as stringent as the requirements laid down in Paragraphs 7-9 of Section B of Annex I of CRAR. In the absence of such alternatives, ESMA recommends that endorsing CRAs ensure that the third-country CRA fulfils the EU rules. ESMA considers that this approach is complementary to the measures proposed under Section 6.2.2.

No text.

Q14. Do you agree with ESMA's view in respect of this provision?

4.6.4 Record-keeping

95. CRAR contains a requirement for CRAs to ensure that credit ratings are treated in the same manner as inside information, up until the point of their disclosure:

Article 6(2): In order to ensure compliance with Paragraph 1, a credit rating agency shall comply with the requirements set out in Section A and B of Annex I.

Paragraphs 7-9 of Section B of Annex I

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 decision, the identity of the rating analysts participating in the determination of the credit rating, the identity of the persons who have approved the credit rating, 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 methodologies used by the credit rating agency to determine credit ratings;

(e) the internal records and files, including non-public information and work papers, used to form the basis of any credit rating decision taken;

(f) credit analysis reports, credit assessment reports and private credit rating reports and internal records, including non-public information and work papers, used to form the basis of the opinions expressed in such reports;

(g) records of the procedures and measures implemented by the credit rating agency to comply with this Regulation; and

(h) copies of internal and external communications, including electronic communications, received and sent by the credit rating agency and its employees, that relate to credit rating activities.

8. Records and audit trails referred to in point 7 shall be kept at the premises of the registered credit rating agency for at least five years and be made available upon request to the competent authorities of the Member States concerned.

Where the registration of a credit rating agency is withdrawn, the records shall be kept for an additional term of at least three years.

9. Records which set out the respective rights and obligations of the credit rating agency and the rated entity or its related third parties under an agreement to provide credit rating services shall be retained for at least the duration of the relationship with that rated entity or its related third parties.

96. **Objective of this Requirement:** The objective of this provision is set out in recitals 27 and 42 of CRA 1. In this regard, recital 27 states that "...Credit rating agencies should disclose conflicts of interest in a timely manner. They should also keep records of all significant threats to the independence of the credit rating agency and that of its employees and other persons involved in the credit rating process, as well as the safeguards applied to mitigate those threats".

97. In addition, recital 42 highlights that the purpose of the record keeping requirements for methodologies is "...to keep a record of the substantial elements of the dialogue between the rating analyst and the rated entity or its related third parties."

98. **CRAs Comments:** Only one CRA provided feedback on the difficulty of implementing this provision in third countries, however this comment is likely to be relevant to more than just one CRA:

- o Lack of consistency in approaches between different jurisdictions: One CRA highlighted that there is no common minimum retention period among global regulators, with periods ranging from 3 years in the US to 7 years in certain Asian jurisdictions. As a result, setting a five-year retention period for files relating to endorsed credit ratings would have the effect of dictating retention requirements in a number of jurisdictions, including the US.

99. **ESMA's view:** ESMA does not consider that CRAs' have identified alternative internal requirements which are as stringent as the requirements laid down in Paragraph 7-9 of Section B of Annex I of CRAR. ESMA considers it important that CRAs ensure the records relating to endorsed credit ratings are retained for a period at least as long as that applicable to ratings issued in the EU, in order to mitigate against asymmetry between the supervisory information available to ESMA.

Proposed CP Text

No text.

Q15. Do you agree with the proposed guidelines in respect of this provision?

Q16. Have you identified any alternatives internal requirements which could meet the same objective and effects of an EU requirement in practice?

5 Summary of questions

Q1	Do you agree with the proposed guidelines in respect of Paragraph 3c of Section B of Annex I?
Q2	Do you agree with the proposed guidelines in respect of Article 11(3) and Point 2 of Part II of Section E of Annex I and the Delegated Regulation on Fees?
Q3	Do you agree with the proposed guidelines in respect of Article 10(3)?
Q4	Do you agree with the proposed guidelines in respect of Article 10(5)?
Q5	Do you agree with the proposed guidelines in respect of Article 12 and Part III of Section E of Annex I?
Q6	Do you agree with the proposed guidelines in respect of Paragraph 6 of Subsection I of Section D of Annex I?
Q7	Do you agree with the proposed guidelines in respect of Article 8(3), (5), (5a) and (6)?
Q8	Do you agree with the proposed guidelines in respect of Article 8(7)(a)?
Q9	Do you agree with the proposed guidelines in respect of Article 7(4) and Paragraph 8 of Section C of Annex I?
Q10	Do you agree with the proposed guidelines in respect of Article 6(1) and Paragraph 3(aa) and (ca) of Section B of Annex I?
Q11	Do you agree with the proposed guidelines in respect of Paragraphs (6)-(7) of Section C of Annex I?
Q12	Do you agree with the proposed guidelines in respect of Article 10(2) and Paragraph 3 of Subsection I of Section D of Annex I?
Q13	Do you agree with the proposed guidelines in respect of Article 10(2a)?
Q14	Do you agree with the proposed guidelines in respect of Article 7(3) and Paragraph 3 of Section C of Annex I?
Q15	Do you agree with the proposed guidelines in respect of Article 6(2) and Paragraphs 7-9 of Section B of Annex I?
Q16	Have you identified any alternatives internal requirements which could meet the same objective and effects of an EU requirement in practice?

6 Cost Benefit Analysis

6.1 Background

1. Under the 2017 Guidelines, ESMA has outlined that there are two approaches available for endorsing credit rating agencies to ensure that endorsed credit ratings meet the relevant endorsement provisions of CRAR, namely:
 - a) The third-country credit rating agency can fulfil the requirements set out in the relevant endorsement provisions of CRAR; or,
 - b) The third-country credit rating agency can establish and fulfil internal requirements that are different but at least as stringent as the relevant endorsement provisions of CRAR.
2. Under the second of these approaches endorsing CRAs can choose to ensure that the third-country CRA establishes their own requirements which are as stringent as the EU requirements, or they can implement one of the “as stringent as” internal requirements suggested by ESMA in these supplementary Guidelines.

6.2 Reasons for Publication

3. The primary purpose of these supplementary Guidelines is to provide guidance when CRAs choose to endorse credit ratings according to the second of the above approaches. This is done by proposing internal requirements ESMA recognises as being “as stringent as” the relevant endorsement provisions for endorsed credit ratings.
4. In addition to proposing guidance on “as stringent as” measures, these supplementary guidelines have a secondary purpose, which is to provide clarity as to how the Endorsement regime established under CRAR and ESMA’s new Guidelines on Endorsement, is expected to work in practice.
5. This CBA should therefore be read as a continuation of the analysis of the costs and benefits discussed in ESMA’s Guidelines on Endorsement. In this regard, whereas that CBA considered the costs and benefits of the endorsement regime as implemented by those Guidelines, this CBA is focused on the costs and benefits resulting from these supplementary guidelines. For this reason, it is argued that these Guidelines do not in and of themselves propose any additional costs that were not already implied by the 2017 Guidelines. As a result, any measures proposed in these supplementary guidelines should be cost reducing as opposed to cost increasing with the focus on reducing initial costs of implementation.

6.3 Impact of the Guidelines

6. For those CRAs who currently endorse credit ratings from third-country CRAs by directly implementing all the requirements set out in the relevant endorsement provisions of CRAR, ESMA's Guidelines on Endorsement, and consequently these supplementary Guidelines will have no impact on initial or ongoing costs. The reasons for this being that the endorsing and third country CRAs are currently adhering to the relevant endorsement provisions of CRAR, as a result, and as outlined in the Guidelines on Endorsement the only additional cost will be of an ad-hoc nature, relating to ESMA's change in approach to Endorsement.
7. For those CRAs who currently endorse credit ratings from third-country CRAs which establish internal requirements that are different but at least as stringent as the relevant endorsement provisions of CRAR, the main benefit of these guidelines is that they will lower the initial costs imposed by the 2017 Guidelines.
8. These initial costs will be lowered by reducing the need for CRAs to dedicate time and resources to the development of their own internal policies and procedures to meet the relevant endorsement provisions of CRAR.
9. However, in addition to reducing the initial costs imposed by the 2017 Guidelines, these Guidelines will also benefit endorsing CRAs by:
 - Providing clarity on the different approaches available to CRAs as to how they can implement the requirements of CRAR in relation to endorsed ratings.
 - Providing guidance on each area of CRAR that CRAs have highlighted as being relevant to the requirements for endorsed credit ratings but that are currently subject to different internal policies and procedures outside of the EU.
 - Facilitating a consistent implementation of the endorsement regime across CRAs through encouraging the adoption of similar "as stringent as" internal requirements.
10. In terms of the costs to be borne by ESMA, it is expected that a higher uptake of these guidelines will mean there will be a greater level of consistency in the policies and procedures of third-country CRAs and therefore a lower supervisory burden for ESMA.
11. On the other hand, a lower uptake of these guidelines will mean there will be a lower level of consistency in the policies and procedures of third country CRAs and therefore a higher supervisory burden on ESMA, which could require a higher level of supervisory fees for CRAs.

6.4 CBA

12. The following table summarises the potential costs and benefits resulting from the implementation of these Guidelines and should be seen as supplementary to the Cost Benefit Analysis set out in Section 3 of ESMA's Guidelines on Endorsement.

<p><i>Ongoing Costs</i></p> <p><i>Ad-Hoc Costs</i></p>	<p>ongoing or ad-hoc costs that were not established by ESMA's Guidelines on endorsement.</p> <p><u>Scenario 2:</u> Where a CRA operates across jurisdictions with very different legal frameworks and does not have harmonised global policies and procedures, these guidelines should be of significant use as the development of one or more "as stringent as" internal requirements may be necessary. As a consequence these supplementary guidelines should reduce the initial costs established by ESMA's Guidelines on Endorsement by saving the CRA from having to develop their own internal requirements that are as stringent as EU measures. In this scenario, ongoing or ad-hoc costs are likely to be the same as those under scenario 1, and in any case not greater than those established in principle by ESMA's guidelines on Endorsement.</p> <p>For ongoing costs, these supplementary guidelines impose no additional costs beyond those that were established in principle by the Guidelines on Endorsement. What these supplementary guidelines do is highlight where those ongoing costs established by the Guidelines on Endorsement are likely to arise.</p> <p>Likewise for costs of an ad-hoc nature it is not expected that these supplementary Guidelines will have any impact on the costs of an ad-hoc nature originating from ESMA's Guidelines on Endorsement.</p>
<p>Costs for ESMA</p>	<p>For ESMA, a higher uptake of these Guidelines will mean there is more consistency in the policies and procedures of third-country CRAs, there would therefore be a reduced supervisory burden, lower costs for ESMA and therefore lower supervisory fees for CRAs.</p> <p>Similarly, a lower uptake of these Guidelines means there will be less consistency among the policies and procedures of third-country CRAs a higher supervisory burden on ESMA and therefore higher supervisory fees for CRAs.</p> <p>A higher uptake of implementing EU rules would mean the highest level of consistency among third-country CRAs, the lowest supervisory burden on ESMA and the lowest impact on supervisory fees charged to CRAs.</p>

Annex I: Guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation

1 Scope

Who?

1. These guidelines apply to credit rating agencies established in the Union and registered with ESMA (hereinafter “EU CRAs”) in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies⁷ (hereinafter “CRAR”) which are endorsing or which intend to endorse credit ratings issued by a third-country CRA in accordance with Article 4(3) of the same Regulation.

What?

2. These guidelines concern particular matters relating to credit ratings issued in third countries and endorsed pursuant to Article 4(3) of CRAR.

When?

3. These guidelines will apply to credit ratings issued on or after 1 January 2019 and to existing credit ratings reviewed after that date.

⁷ OJ L 302, 17.11.2009, p.1.

2 Definitions, legislative references and acronyms

The following definitions apply:

CRA	Credit rating agency
CRAR	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 2	Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation (EC) No 1060/2009 on credit rating agencies
CRA 3	Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies
ESMA	European Securities and Markets Authorities
ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (ESMA Regulation)
Delegated Regulation on Fees	The European Commission Delegated Regulation (2015/1) of 30 September 2014 supplementing CRAR with regard to regulatory technical standards for the periodic reporting on fees charged by credit rating agencies for the purpose of ongoing supervision by the European Securities and Markets Authority
EU CRA	A credit rating agency registered with ESMA.
Endorsing CRA	An EU CRA which endorses or has endorsed one or more credit ratings in accordance with Article 4(3) of CRAR.
Third-country CRA	A CRA which is registered and subject to supervision in a non-EU country.
Group of CRAs	As per Article 3(1)(m) of CRAR 'group of CRAs' means a group of undertakings established in the Union consisting of a parent undertaking and its subsidiaries within the meaning of Articles 1 and 2 of Directive 83/349/EEC as well as undertakings linked to each other by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC and whose occupation includes the issuing of credit ratings. For the

	purposes of Article 4(3)(a), a group of credit rating agencies shall also include credit rating agencies established in third countries;
The relevant endorsement provisions of CRAR	The provisions quoted in Article 4(3)(b) of CRAR: Articles 6 to 12 and Annex I of CRAR 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.

3 Purpose

4. Article 21(3) of CRAR requires ESMA, in cooperation with EBA and EIOPA, to issue and update guidelines on the application of the endorsement regime under Article 4(3) of CRAR. In order to fulfil the requirements placed upon it by Article 21(3), ESMA is updating the Guidelines on Endorsement published on 17 November 2017.
5. With these guidelines, ESMA aims to bring clarity about the conditions for endorsement laid down in Article 4(3) of CRAR.

4 Compliance and reporting obligations

4.1 Status of the guidelines

6. This document contains guidelines issued pursuant to Article 16 of the ESMA Regulation and Article 21(3) of CRAR. In accordance with Article 16(3) of the ESMA Regulation, CRAs must make every effort to comply with the guidelines.

4.2 Reporting requirements

7. ESMA will assess the application of these guidelines by the CRAs through its ongoing supervision and monitoring of CRAs' periodic reporting to ESMA.

5 Guidelines

5.1 Initial conditions for endorsement

8. An EU CRA should not begin endorsing credit ratings before ESMA has completed two separate assessments, namely: (1) an assessment of the conditions relating to the legal and supervisory framework of the third country as described in Annex II (the Methodological Framework for Endorsement); and, (2) an assessment of certain conditions relating to the CRAs intending to endorse credit ratings.

5.2 Ongoing obligations of an endorsing CRA

9. ESMA expects that an endorsing CRA notifies ESMA if it becomes aware that one or more of the conditions initially assessed by ESMA are no longer fulfilled. As a good practice, the internal audit function should regularly review the control environment for endorsement.
10. In addition, an endorsing CRA should ensure that it meets the following requirements on an ongoing basis.

Requirements relating to Article 4(3)(b)

11. ESMA considers that compliance of the third-country CRA with the third-country legal and supervisory framework does not in and of itself prove that the third-country CRA is fulfilling requirements which are “as stringent as” the requirements set out in Articles 6 to 12 and Annex I of CRAR 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 (hereinafter “the relevant endorsement provisions of CRAR”).
12. Instead, ESMA expects that the endorsing CRA has verified and is able to demonstrate that the third-country CRA has established internal requirements which are at least as stringent as the corresponding requirements in the relevant endorsement provisions of CRAR. ESMA, furthermore, expects that the endorsing CRA has verified and is able to demonstrate that the conduct of the third-country CRA fulfils the internal requirements set out by the third-country CRA on an ongoing basis.
13. Where the third-country CRA chooses to directly fulfil the requirements set out in the relevant endorsement provisions of CRAR, ESMA does not expect the endorsing CRA to demonstrate that the third-country CRA has established internal requirements which are as stringent as the relevant EU requirements. In this case, ESMA only expects that the endorsing CRA verifies and is able to demonstrate that the conduct of the third-country CRA fulfils the relevant EU requirements.
14. To be able to fulfil the requirements described above, ESMA expects that the endorsing CRA has put in place measures to:

- (a) monitor the policies and procedures of the third-country CRA: Such measures should include an initial assessment of the relevant policies and procedures in the third-country CRA, which should be carried out to ensure that they meet the requirements in Article 4(3)(b) of CRAR. Any subsequent material changes to the relevant policies and procedures in the third-country CRA should also be reviewed and assessed.
 - (b) monitor the conduct of the third country CRA: such measures should ensure that the endorsing CRA is able to demonstrate to ESMA on an ongoing basis that the relevant policies and procedures of the third-country CRA are adhered to, for example through basic automated checks, periodic deep dive assessments of the compliance of a sample of endorsed credit ratings with specific requirements or areas of requirements and/or review of documentation produced by the key control functions of the third-country CRA.
15. The endorsing CRA should ensure that the above-described measures are based on appropriate and effective organisational and administrative arrangements and clear decision-making procedures, which allocate roles and responsibilities.
16. Whenever the endorsing CRA finds that the conduct of the third-country CRA may not fulfil requirements which are as stringent as the relevant endorsement provisions of CRAR, ESMA expects that the endorsing CRA informs ESMA and takes appropriate steps. The steps should be proportionate and may include:
- (a) requesting clarification from the third-country CRA;
 - (b) taking appropriate remedial action;
 - (c) suspending endorsement of new ratings which may be affected by the potential breach;
 - (d) withdrawing outstanding endorsed ratings which may be affected by the potential breach.

Requirements relating to Article 4(3)(c)-(d)

17. With regard to point (c) of Article 4(3) of CRAR, the endorsing CRA should make available to ESMA, on an ad-hoc or periodical basis, any information which ESMA may need in order to be able to assess and monitor the compliance of the third-country CRA with the requirements laid down in Article 4(3)(b).
18. If the endorsing CRA identifies any factors outside of its control which may create limitations to ESMA's ability to assess and monitor the compliance of the third-country CRA, for example resulting from third-country legislation, ESMA expects that the endorsing CRA informs ESMA without undue delay.
19. With regard to point (c)-(d) of Article 4(3) of CRAR, when requested, in order to supervise EU CRAs on an ongoing basis, ESMA expects that the endorsing CRA provides any

relevant information relating to an endorsed credit rating or the conduct of the third-country CRA.

Requirements relating to Article 4(3)(e)

20. ESMA considers that the following should, inter alia, be considered objective reasons within the meaning of Article 4(3)(e):

- (a) when a rated entity or instrument is non-EU⁸;
- (b) when an endorsed credit rating relating to an EU entity or instrument is dependent on the rating of a subsidiary or parent company of the rated entity which is non-EU;
- (c) when only a small part of a CRA's outstanding ratings in a narrowly defined asset class are EU entities or instruments and when analytical staff specialised in this asset class is based outside the EU. However, a CRA should continually ensure that it has specialised analytical staff based in the EU in proportion to the relevance of the asset class in the EU; and
- (d) when an event occurs that temporarily impacts the allocation of analytical capacity of a group of CRAs, such as in the following cases:
 - i. A CRA has only recently opened an EU office and the staff that have the experience to rate some EU entities or asset classes are not yet based in the EU.
 - ii. A corporate action such as a takeover or merger, if the rating activity no longer reflects the new corporate structure.
 - iii. Absence of key analytical staff which could not reasonably have been foreseen or planned for.

21. In order to rely on objective reasons referred to in paragraph 21(d), a CRA should be able to demonstrate to ESMA that it is taking the necessary steps to enable the gradual transfer of these ratings to the EU.

22. The endorsing CRA should notify ESMA when the objective reasons for elaborating endorsed credit ratings outside the EU, deviate from those indicated to ESMA. To be able to fulfil this requirement and to allow ESMA to assess the objective reason for individual ratings, ESMA expects that the endorsing CRA documents the objective reason for each endorsed credit rating and verifies periodically that the indicated objective reason for an outstanding endorsed credit rating remains valid.

⁸ For the purposes of these Guidelines, the country of an entity or financial instrument follows Articles 4-6 as well as Field 10 of Table 1 of Part 2 of Annex I of the Commission delegated Regulation 2015/2 of 30 September 2014 with regard to regulatory technical standards for the presentation of the information that CRAs make available to ESMA, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.002.01.0024.01.ENG

5.3 Requirements which ESMA considers at least as stringent as those set out in Articles 6-12 and Annex I of CRAR

23. ESMA considers that a requirement can be considered to be as stringent as a requirement set out in CRAR within the meaning of Article 4(3)(b) when it achieves the same objective and effects in practice.
24. The following is a non-exhaustive list of alternative internal requirements which ESMA considers to be at least as stringent as a requirement set out in one of the relevant endorsement provisions of CRAR. However, where no alternative internal requirement is provided in these Guidelines, ESMA recommends that the endorsing CRA ensures that the third-country CRA directly fulfil the requirements set out in the relevant endorsement provisions of CRAR as per paragraph 13 above.

Requirements relating to fees charged by CRAs

25. **Article 11(3) and Point 2 of Part II of Section E of Annex I of the CRA Regulation as further specified in the Delegated Regulation on Fees**⁹: ESMA considers that the endorsing CRA has demonstrated to ESMA that the conduct of the credit rating activities by the third-country CRA resulting in the issuing of an endorsed credit rating fulfils requirements which are at least as stringent as those set out in CRAR, where the endorsing CRA reports the information set out in these provisions to ESMA for a credit rating it has endorsed and related ancillary services in accordance with the Delegated Regulation on Fees.
26. In place of reporting the fee schedules, fee programmes and pricing procedures in accordance with Article 2 and tables 2-4 of Annex I of the Delegated Regulation on Fees, the endorsing CRA may choose to submit to ESMA a list of all deviations from its pricing policies or pricing procedures, or the non-application of a pricing policy, fee schedule or fee programme, or pricing procedure with a clear identification of the main explanations for the deviation which are to be recorded in accordance with Article 3(3) of Annex II of the Delegated Regulation on Fees.

Requirements to accompany the disclosure of a credit rating with certain information

27. **Article 10(5)**: ESMA considers that the disclosure of participation status without using a colour code can be considered as stringent as the requirement to disclose participation status using a colour code, if the illustration of participation status is equally prominent.

Other disclosure requirements

28. **Article 12 and Part III of Section E of Annex I**: ESMA considers that the endorsing CRA has demonstrated to ESMA that the conduct of the credit rating activities by the third-

⁹ The European Commission Delegated Regulation (2015/1) of 30 September 2014 supplementing CRAR with regard to regulatory technical standards for the periodic reporting on fees charged by credit rating agencies for the purpose of ongoing supervision by the European Securities and Markets Authority.

country CRA resulting in the issuing of an endorsed credit rating fulfils requirements which are as stringent as those set out in these provisions, where the endorsing CRA includes information about the endorsed credit ratings in its own transparency report. Specifically:

- a. the description of the internal control mechanisms ensuring quality of a CRA's credit rating activities should include control mechanisms applicable to endorsed credit ratings;
- b. the outcome of the annual internal review of a CRA's independent compliance function should take into account the compliance of endorsed credit ratings;
- c. the description of the policy for record-keeping and analyst rotation should indicate whether such policies are global or only applied to EU ratings; and
- d. the financial information on the revenue of the endorsing CRA, including total turnover and the geographical allocation of that turnover to revenues generated in the Union and revenues worldwide should clearly state whether revenues from endorsed ratings are taken into account.

29. **Point 6 of Part I of Section D of Annex I:** ESMA considers that internal requirements established by a third-country CRA can be considered as stringent as those set out in these provisions, where they ensure that the third-country CRA take steps to mitigate the risks posed by rating shopping.

Requirements regarding the review and disclosure of methodologies

30. **Article 8(7)(a):** ESMA considers that the endorsing CRA has demonstrated to ESMA that the conduct of the credit rating activities by the third-country CRA resulting in the issuing of an endorsed credit rating fulfils requirements which are at least as stringent as those set out in CRAR, where the endorsing CRA reports the information set out in these provisions to ESMA for a credit rating it has endorsed, in the same manner it reports such information for credit ratings issued in the EU.

Requirements regarding independence and conflicts of interest

31. **Article 7(4) and Point 8 of Section C of Annex I:** ESMA considers that internal requirements established by a third-country CRA can be considered as stringent as those set out in these provisions, where they ensure the third-country CRA:

- a. records the length of time an analysts or persons approving credit ratings with a single issuer;
- b. ensures that analysts and persons approving credit ratings are subject to an appropriate rotation mechanism which provides for a gradual change in analytical teams and credit rating committees; and

- c. has in place dedicated and robust internal requirements relating to potential conflicts of interest between an analyst and a rated entity.

Requirements regarding the treatment of information relating to a credit rating prior to publication

- 32. **Paragraph 3 of Subsection I of Section D of Annex I**: ESMA considers that internal requirements established by a third-country CRA can be considered as stringent as those set out in these provisions, where they ensures that the third-country CRA:
 - a. notifies a rated entity about a rating action in advance of publication;
 - b. during the business hours of the rated entity; and
 - c. provides the rated entity with a reasonable amount of time to provide feedback on any material errors.
- 33. **Article 10(2a)**: ESMA considers that internal requirements established by a third-country CRA can be considered as stringent as those set out in these provisions, where they ensure that the third-country CRA treats credit ratings, rating outlooks and information related thereto according to that third-country regime's requirements for the handling of inside information up until the point of publication/disclosure.