



European Securities and
Markets Authority

Follow-up Report

**Follow-up to the Thematic Report on fees charged by Credit Rating
Agencies and Trade Repositories**





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Executive Summary

1. The European Securities and Markets Authority (ESMA) in its 2018 Thematic Report on fees charged by Credit Rating Agencies (CRAs) and Trade Repositories (TRs) (the Thematic Report)¹, reviewed how the CRA and TR industries had implemented the fees provisions in the CRA Regulation (CRAR) and the European Market Infrastructure Regulation (EMIR). CRAR requires that fees charged for credit ratings and ancillary services are non-discriminatory and based on the actual costs of these services. EMIR requires that TRs provide non-discriminatory access to their services and ensure that the fees charged are cost-related and publicly disclosed.
2. The Thematic Report summarised ESMA's observations and supervisory concerns. ESMA was concerned that although the regulatory provisions on fees had been in place for several years, it was not able to conclude whether and how the regulatory requirements were met by observing CRAs' and TRs' practices. The Thematic Report identified the key areas where ESMA expected supervised firms to enhance their practices to demonstrate compliance with the regulatory requirements. ESMA found that supervised firms' transparency and disclosure to clients of fees related information and the fee setting and costs monitoring processes needed to be improved. ESMA further highlighted that it did not have enough visibility of the commercial relationships in place between CRAs or TRs and other companies within their respective groups and was concerned that these arrangements could conflict with the regulatory requirements and create risks for investor protection. ESMA committed to continue engaging with supervised firms, related third parties and users of CRAs' and TRs' services to: (i) ensure effective supervision of the fees provisions, (ii) obtain further information regarding the commercial arrangements in place between CRAs and other companies within CRAs' groups providing credit rating services to users of ratings, and (iii) further clarify its expectations where necessary.
3. The objective of the Follow-up Report is to provide an update on the work ESMA has conducted since the publication of the Thematic Report. It examines developments in industry practices and highlights good practices that have been implemented as well as areas where further improvements are needed to ensure compliance with the fees provisions of the CRAR and EMIR.
4. ESMA has found that CRAs and TRs have made improvements in the areas of transparency, fee setting and costs monitoring. Nevertheless, further improvements are still required with regard to costs recording and monitoring. ESMA expects all supervised firms to be able to record costs at a sufficient level of granularity to be able to demonstrate the fees charged are cost-based (for CRAs) and cost-related (for TRs).
5. ESMA found that access to and use of credit ratings published on the websites of the three largest CRAs operating in the EU was severely limited. In response, these CRAs have recently proposed changes to the terms of their websites which should allow individual credit ratings to be used for regulatory reporting in future. ESMA will monitor the implementation of these changes to assess their impact on users of credit ratings. However, ESMA remains concerned that users of credit ratings still need to enter into licence agreements for credit ratings data feeds which are distributed by information services companies affiliated to CRAs. ESMA is concerned that CRAs do not exercise

¹See ESMA Thematic Report On fees charged by Credit Rating Agencies and Trade Repositories; 11 January 2018 ESMA80-196-954, published at: https://www.esma.europa.eu/sites/default/files/library/esma80-196-954_thematic_report_on_fees_charged_by_cras_and_trs.pdf



any direct control over the credit ratings distribution and licence services provided by these companies. ESMA will monitor the implementation of changes to the terms of use of credit ratings published on CRAs' websites and will continue to work on improving access to and use of credit ratings.

6. ESMA expects CRAs and TRs to take note of the good practices and areas for improvement identified in this report and to consider how they can implement these where they have not already done so. ESMA will continue to monitor how supervised firms develop their practices in these areas and to assess their compliance with the regulatory requirements on fees.

1 Introduction

7. On 11 January 2018, ESMA published a Thematic Report on fees charged by Credit Rating Agencies and Trade Repositories. The Thematic Report examined the application of the provisions of the CRAR and EMIR regarding the fees charged for credit ratings and ancillary services as well as access to TR services. The Thematic Report set out ESMA's supervisory concerns and identified the following areas for improvement by CRAs and TRs and for ESMA's future supervisory focus:
 - i) Transparency and disclosures;
 - ii) Costs monitoring and fee setting;
 - iii) Interactions with related companies.
8. ESMA found that the fee schedules and related information that CRAs provided to their clients were not clear enough for them to be able to understand the key elements of the fees proposed to them and the reasons for any fee increases or deviations from fee schedules. ESMA found that TRs' published fee schedules were so complex that clients could not easily compare them to understand the costs of connecting to different TRs and accessing different services. ESMA also highlighted that it did not receive sufficient information to be able to effectively monitor compliance with the fees provisions, in particular as regards supervised firms' costs, deviations from fee schedules and the internal controls in place to monitor compliance with the fees provisions.
9. ESMA found that both CRAs and TRs needed to improve their overall fee setting processes, from the initial phase of establishing their fee schedules through to the application of these fee schedules to clients, to make sure that costs are a key factor in determining pricing and that sufficient internal controls are in place to ensure compliance with the regulatory provisions.
10. ESMA highlighted that the relationships between both CRAs and TRs and other companies within their respective groups could conflict with the regulatory requirements as they were not transparent and could give rise to conflicts of interests as well as posing risks to investor protection. In particular, ESMA noted the potential risks associated with the distribution of credit ratings and related services through the information services companies which formed part of the CRAs' groups. ESMA found that CRAs did not exercise any direct controls over how credit rating information and related content was used, marketed and distributed by these companies. ESMA also found that TRs were often part of larger groups of companies and that they frequently outsourced functions to other companies within these groups. ESMA raised concerns that this could create barriers to new entrants or disadvantage existing market players that did not benefit from the same level of group support.
11. Following the publication of the Thematic Report, ESMA engaged with supervised firms, their clients and client associations to understand the actions CRAs and TRs were taking in order to meet ESMA's expectations. ESMA selected a sample of six of the largest CRAs and one TR on the basis of their market presence and pricing practices and recommended that they perform internal audits to better understand how they were incorporating the findings of the Thematic Report into their processes. In addition, ESMA monitored closely the information received from supervised firms through periodic reporting, such as compliance reports, board minutes and notifications of material changes, including changes to fee schedules or pricing policies. ESMA also sent specific requests for

information to information services companies affiliated to CRAs to better understand the credit rating related products and services that they provide to users of credit ratings in the EU.

12. ESMA also conducted policy work to improve the nature and content of the information reported by supervised firms about the fees charged to their clients. In particular, ESMA enhanced periodic reporting requirements for both CRAs and TRs to better demonstrate how these firms comply with the fee-related provisions of the CRAR and EMIR. In February 2019, ESMA published the revised Guidelines on the submission of periodic information to ESMA by Credit Rating Agencies.² In May 2019 ESMA published a Consultation Paper on the Guidelines on periodic information and notification of material changes to be submitted to ESMA by Trade Repositories.³ Both sets of Guidelines streamline the information that is reported to ESMA and introduce specific templates for the regular reporting of revenues and costs information which will facilitate supervision of whether the fees charged by supervised firms are cost-related (for TRs) and cost-based (for CRAs).
13. Through its follow up work, ESMA has identified a number of areas where supervised firms and their clients may not have been clear about ESMA's interpretation of the fees provisions. Some further clarifications have been included in this report, and ESMA may decide to conduct further policy work in this area in future.
14. ESMA has identified a number of good practices in the areas of transparency, fees setting and cost monitoring during the course of its follow up work. It has shared these to demonstrate how practices have evolved within the CRA and TR industries and to provide additional guidance to supervised firms as they continue to implement the fees provisions of the regulations. ESMA expects CRAs and TRs to reflect on the good practices highlighted and consider where there may be scope to implement these where they have not already done so.
15. ESMA has identified that further improvements are needed, in particular as regards costs monitoring by both CRAs and TRs and as regards access to and use of credit ratings. ESMA expects CRAs and TRs to take concrete action to improve their practices in these areas. ESMA will continue to monitor how supervised firms develop their practices and will assess whether and how the implementation of these changes supports compliance with the regulatory requirements on fees.
16. Section 1 of this report provides relevant background information and gives an overview of its contents. Section 2 focuses on developments in CRA industry practices regarding transparency and disclosure, fee setting and costs monitoring and access to and use of credit ratings. Section 3 reports on developments in TR industry practices regarding transparency and disclosure and fee setting and costs monitoring. Both sections 2 and 3 identify good practices and areas for further improvement in the respective industries and provide summary tables for ease of use. Section 4 briefly highlights ESMA's conclusions

² See ESMA Final Report - Guidelines on the submission of periodic information to ESMA by Credit Rating Agencies – 2nd Edition; 5 February 2019 ESMA33-9-295, published at: https://www.esma.europa.eu/sites/default/files/library/esma_33-9-295_final_report_guidelines_on_the_submission_of_periodic_information_to_esma_by_credit_rating_agencies.pdf

³ See Consultation Paper - Guidelines on periodic information and notification of material changes to be submitted to ESMA by Trade Repositories; 23 May 2019 ESMA70-145-1145, published at: https://www.esma.europa.eu/sites/default/files/library/esma70-145-1145_guidelines_on_periodic_information_to_be_submitted_to_esma_by_trade_repositories_0.pdf



and next steps. A factsheet summarising ESMA's findings is provided in Annex I of the report.

2 Credit Rating Agencies

17. The Thematic Report examined CRAs' established practices and set out ESMA's key supervisory concerns in the areas of transparency and disclosure; the cost monitoring and fee setting processes; and interactions with CRAs' related companies. It also clarified ESMA's expectations regarding the requirement of the CRAR that the fees charged to CRAs' clients for the provision of credit rating and ancillary services are non-discriminatory and based on actual costs.⁴
18. As part of its follow-up work, ESMA continued its engagement with both supervised firms and users of credit rating services to understand how industry practices have evolved since the publication of the Thematic Report.
19. In particular, ESMA reviewed information submitted by CRAs as part of their periodic reporting, including board minutes, compliance reports and internal audit reports. ESMA also assessed notifications of material changes relating to fee schedules and pricing policies. In addition, ESMA followed-up with a sample of 6 CRAs based on their market presence and pricing practices, to discuss in more detail the material changes they implemented or planned to implement in response to the Thematic Report. In some cases, where no changes were foreseen, ESMA asked CRAs to carry out an internal audit to assess how their fees setting and costs monitoring processes met the requirements of the fees provisions.
20. ESMA notes that CRAs have matured in their approach to the fees provisions. They now generally recognise that the aim of these provisions goes beyond the prevention of conflicts of interest and ensuring the independence of the rating process from the fees charged to the clients and also extends to facilitating fair competition in the CRA industry. However, ESMA also received feedback from some CRAs questioning how its expectations achieve these regulatory objectives. Such clarifications are provided in section 2.1.
21. ESMA welcomes the way in which both large and small CRAs have discussed the Thematic Report's findings at Board level and have increased the Board's oversight of the fees provisions. In addition, some CRAs used the findings of the Thematic Report to revise their fee setting and costs monitoring processes. Other CRAs conducted an internal audit to assess how their current processes meet the cost-based and non-discriminatory principles and the need for more transparency set out in the Thematic Report.
22. Sections 2.2 and 2.3 provide a summary of the key developments and good practices that ESMA has observed during its follow-up work and identify areas for further improvement. For the convenience of the readers of this report, at the end of each section ESMA provides a list of good practices identified.
23. None of the CRAs in ESMA's sample has put in place the full set of good practices described below. ESMA particularly notes and appreciates cases where CRAs have adopted a holistic approach and have reconsidered their end-to-end process, from the initial phase of setting fee schedules and fee programmes based on costs to the final phase of charging clients based on the established fee schedules and programmes,

⁴ CRA Regulation, Annex I, Section B, point 3c: "A credit rating agency shall ensure that fees charged to its clients for the provision of credit rating and ancillary services are not discriminatory and are based 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."

including implementing mechanisms for monitoring compliance with the fees provisions. ESMA encourages CRAs to implement the good practices identified as they continue to refine their approach to the fees provisions of the CRAR.

24. Before analysing changes in CRAs' practices, it is important to note how the industry has changed since the publication of the Thematic Report in January 2018.
25. There are currently 41 individual legal entities registered as CRAs operating in the EU. Given that some of the registered CRAs belong to the same group, there are currently 27 different CRAs or groups of CRAs operating in the EU under ESMA's supervision. Between January 2018 and December 2019, 5 new CRAs were registered with ESMA and 6 CRAs were deregistered as shown in the table below:

Table 1: CRAs registered and deregistered between January 2018 - December 2019

Name of CRA	Country of establishment	Status	Effective date
Nordic Credit Rating AS ⁵	Norway	Registered	3 August 2018
Moody's Investors Service (Nordics) AB	Sweden	Registered	13 August 2018
SPMW Rating Sp. z o.o.	Poland	Deregistered	10 October 2018
A.M. Best (EU) Rating Services B.V.	The Netherlands	Registered	3 December 2018
DBRS Rating GmbH	Germany	Registered	14 December 2018
S&P Global Ratings Italy S.r.l	Italy	Deregistered	20 December 2018
S&P Global Ratings France SAS	France	Deregistered	20 December 2018
Inbonis SA	Spain	Registered	27 May 2019
Moody's Investors Service EMEA Ltd	UK	Deregistered	2 July 2019
Beyond Ratings SAS	France	Deregistered	5 July 2019
DG International Ratings SRL (previously Dagong Europe Credit Rating Srl)	Italy	Deregistered	14 November 2019

Source: ESMA

26. 6 of the 11 changes listed above were part of CRAs' contingency plans to allow them to continue providing credit ratings in the EU in the event that the UK leaves the EU. Of the

⁵ Registered by the EFTA Surveillance Authority as a credit rating agency under the CRAR as incorporated into the Agreement on the European Economic Area. This decision was adopted by the EFTA Surveillance Authority on the basis of a draft prepared by ESMA.

remaining 5 changes, two new EEA CRAs were registered (one in Norway and one in Spain), and three CRAs were deregistered (one in Poland, one in France and one in Italy).

27. There have not been any significant changes in CRAs' overall market presence since the Thematic Report was published in January 2018. The groups of the three largest CRAs operating in the EU provide the vast majority of credit ratings and they have a combined market share by revenue of around 95%. However, an analysis of the distribution of credit ratings by asset class reveals that DBRS and Scope Ratings are continuing to establish a presence in the markets for structured finance and corporate financial and non-financial ratings.⁶

2.1 Clarifications following ESMA's 2018 Thematic Report

28. ESMA received feedback from some CRAs that a few of the expectations set out in the Thematic Report would undermine rather than facilitate fair competition in the CRA industry. This related specifically to the requirement that costs should be a key pricing factor.⁷ They argued that ESMA's approach to price discrimination was too strict and that some form of value-based pricing and price discrimination should be favoured as this would facilitate rather than prevent fair competition.
29. Some CRAs argued that the requirements of the fees provisions are met if the CRA ensures that business interests do not impair the independence and accuracy of the credit rating activities and ensures that the fees charged do not depend on the level of the credit rating assigned.
30. It is important to clarify that, while the independence of the credit rating activities from the CRAs' commercial interests is an important objective of the CRAR, it is not in itself sufficient to ensure compliance with the fees provisions. These establish that CRAs' fees must be 'cost-based' and 'non-discriminatory'.
31. As set out in the Thematic Report, ESMA considers that these two pricing principles are closely linked. This is clear from the wording of the CRAR which states that '*In order to further mitigate conflicts of interest and facilitate fair competition in the credit rating market, it is important to ensure that the **fees charged by credit rating agencies to clients are not discriminatory. 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***'.⁸ (emphasis added)
32. ESMA's approach to the fees provisions does not aim to establish a fee setting regime for CRAs, or to impose a pre-defined fee structure or margin level. As explained in the Thematic Report, ESMA recognises that CRAs' fee structures can incorporate a variety of additional elements which may not be directly linked to cost factors and may vary across CRAs. However, that is not in contradiction with the need to ensure that fees are cost-based, and specifically that the fee setting process is based on a sufficiently detailed degree of costs information.⁹

⁶ See Report on CRA Market Share Calculation, 29 November 2019 ESMA33-9-340, published at: https://www.esma.europa.eu/sites/default/files/library/esma_33-9-340_cra_market_share_calculation_2019.pdf

⁷ See Point a) of Paragraph 81 of the Thematic Report.

⁸ Recital 38 of Regulation (EU) No 462/2013 of the European Parliament and Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies

⁹ See Paragraph 80 of the Thematic Report.

33. While the regulatory principle of non-discriminatory pricing is that ‘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’, ESMA clarified in the Thematic Report that this requirement does not prevent CRAs from offering price reductions, such as discount programmes, rebates, special offers and pricing programmes, as long as these are offered to all similar types of users on the same grounds. To assess whether special offers are harmful to the market it is crucial to consider the market power of the entity using the pricing practices and the effect of the practices.¹⁰
34. A further area which requires additional clarification relates to CRAs’ cost monitoring practices. ESMA has observed that CRAs have adopted very different approaches in response to the Thematic Report. In particular, some CRAs were reluctant to explore any enhancements in their cost monitoring practices and have questioned the level of detail in which costs should be monitored.
35. Through its follow-up work, ESMA has re-assessed its expectations as to costs monitoring. From its review of changes in CRAs’ practices and the good practices observed (see section 2.3.1 on cost monitoring for details), ESMA believes that its expectations are valid and are achievable. There is substantial room for CRAs’ to improve their approaches to costs monitoring in order to align these with the expectations set out in the Thematic Report.
36. ESMA understands the difficulties associated with enhancing cost monitoring practices. ESMA acknowledges that this can be a complex and lengthy process, in particular for those CRAs that have established costs monitoring processes only for the purpose of producing corporate financial statements.
37. In ESMA’s view, a more granular approach to costs recording than that used for preparing Profit and Loss statements is needed to ensure that reputational and other intangible costs can be used in the fee setting process.
38. As some CRAs have demonstrated that it is possible to align their costs monitoring practices with the expectations set out in the Thematic Report, ESMA considers that there are no obvious business or technical barriers preventing other CRAs from also enhancing their costs monitoring and allocation practices. ESMA therefore expects to see further improvements in the practices of those CRAs which currently carry out only a very high level of costs aggregation to ensure that fees charged for credit ratings and ancillary services are based on the actual costs of providing these services.
39. ESMA welcomes the opportunity to continue its dialogue with CRAs’ staff as well as with their internal control functions and Board members about any of the points raised in the Thematic Report or in this Follow-up report.

2.2 Transparency and disclosure

40. In the Thematic Report, ESMA highlighted that transparency is crucial as it supports non-discriminatory fees practices and helps prevent arbitrary pricing. It also allows clients to make informed decisions about the products and services they are purchasing.

¹⁰ See Paragraph 12 of the Thematic Report.

41. ESMA clarified that CRAs need to provide sufficiently clear and comprehensive information to actual and potential clients as well as to ESMA. CRAs' clients should be able to understand the key elements and drivers of the fee schedules which apply to them as well as the reasons for any fee increases or deviations from fee schedules.
42. The finding in the Thematic Report which called for improvements in CRAs' transparency and disclosure practices was broadly accepted. CRAs acknowledged that clients need clear and transparent information about fees charged for credit ratings and ancillary services to be able to make informed decisions. CRAs considered ways to enhance transparency towards both existing and prospective clients. CRAs also considered how to strike the necessary balance between providing greater disclosure and the need to protect price sensitive information so as not to jeopardise the independence of staff involved in rating activities or to facilitate collusive pricing practices amongst CRAs.¹¹
43. Through its follow-up work, ESMA observed the following good practices, either already implemented, or in the process of being implemented, by CRAs:
 - a) **Revising pricing policies** to ensure that these embed all the fee-related requirements and principles established by the CRAR, including both the cost-based and non-discriminatory principles.¹² ESMA has seen a number of examples of pricing policies which reflect these principles, rather than just repeating the wording of the regulatory provision. Further examples of comprehensive pricing policies and related documents are those which provide a good compliance-oriented foundation for CRAs' fee setting processes and commercial activities, including the role of commercial staff in interactions with customers, aiming at helping clients to better understand the rationale for the fees charged.
 - b) **Publishing pricing policies on websites.** In general, CRAs' pricing policies do not include specific fee-related or fee sensitive commercial information but instead provide the framework and principles that the CRAs' apply to calculate the fees they charge. ESMA sees the benefit in CRAs' being transparent towards their clients about the guiding principles followed in their pricing process and in disclosing their overall pricing policy.
 - c) **Simplifying and standardising fee schedules and fee programmes** so that clients can more readily identify the relevant fee schedule or programme applicable to each product or service they purchase. This approach makes it easier for clients to understand how the fees charged are calculated, ensures that clear and objective criteria are applied to the granting of discounts and that any deviation from fee schedules or programmes is non-discriminatory and based on objective reasons.
 - d) **Applicable fee schedules and/or fee programmes are provided to both new and prospective clients as well as to existing clients** when changes in the fee schedule or programme applied trigger changes in the fees charged. As described in section 2.3.2 on the fee setting process, ESMA has also observed that some CRAs' fee schedules and programmes already include cost factors, including explicit links between the fees applied and the cost components. Sharing such structured fee schedules and programmes with clients would further enhance the

¹¹ See Paragraph 71 of the Thematic Report.

¹² ESMA notes that measures ensuring the independence of and separation between CRAs' commercial and analytical activities, are already included in CRAs' policies as standard practice.

degree of transparency towards CRAs' customers. ESMA takes the view that this helps clients better understand the key drivers of pricing changes.

- e) **Putting greater emphasis on the regulatory provisions on fees in the training programmes** provided to all staff involved in the fee setting and cost monitoring processes, to promote greater compliance with the fees provisions and greater transparency in fees discussions with clients.
- f) **Developing a price quoting tool or on-line fees calculator** to allow customers to better understand the fees charged for particular credit rating products or services. In ESMA's view, simplifying and standardising fee schedules and programmes as noted in point c) above should also make it easier for CRAs to develop these tools.

44. ESMA strongly encourages CRAs to ensure that their pricing policies, fee programmes and fee schedules are developed with their clients' needs in mind and are accessible and transparent enough to allow clients to make informed decisions as well as to understand the key elements and drivers of the specific fees applied to them and the fee changes made over time. On this basis, ESMA expects all CRAs to consider how they can implement the following good practices:



Interactions and communications with clients are governed by policies, procedures and standards developed using the cost-based and non-discriminatory regulatory requirements

Clear explanations to customers of the rationale for fees charged and reasons for any changes

Pricing policies are publicly disclosed

Fee schedules and discount criteria are standardised and shared with clients

Staff training programmes on fees emphasise the regulatory requirements

Quoting tool made available to clients

2.3 Costs monitoring and fee setting

45. In the Thematic Report, ESMA highlighted that thorough costs recording and monitoring is crucial to ensure cost-based pricing. Weak costs monitoring impairs CRAs' ability to use costs information to set fair and reasonable fees which are cost-based.

46. ESMA clarified that CRAs need to ensure that costs are a key pricing factor and that sufficient controls are in place to demonstrate that the regulatory objectives regarding pricing are met. ESMA highlighted the importance of thorough costs monitoring as the basis of the CRAs' fee setting processes. CRAs should be able to monitor and break down costs in a way that ensures costs information is effectively taken into consideration. Moreover, CRAs should establish regular reviews and controls over costs and their relationship to fees charged, as well as over the deviations between the actual prices

charged and the fee schedules applied, in order to ensure cost-based and non-discriminatory pricing is implemented in practice.

2.3.1 Cost monitoring

47. ESMA stressed in the Thematic Report that CRAs' costs monitoring, and allocation processes should ensure that costs information can be taken into account in a practical and meaningful manner during the fee setting process to ensure that costs are a key pricing factor. With that objective in mind, ESMA's expectation is that costs are monitored in a way which reflects the fees structure put in place by the CRA. ¹³
48. In the Thematic Report, ESMA noted material differences in CRAs' cost allocation and monitoring processes, with some CRAs having undeveloped cost monitoring in place. CRAs with more advanced costs monitoring processes in place recorded direct versus indirect costs, fixed versus variable costs, tangible versus intangible costs and costs broken down by asset class, product or service, geography.
49. Based on its follow-up work, ESMA appreciates that CRAs recognise that a lot can be done to enhance their cost monitoring practices and how they monitor these. However, ESMA also notes that CRAs are cautious about the level of cost granularity that should be implemented and the feasibility of related costs monitoring.
50. ESMA reiterates that, in line with the Thematic Report, ¹⁴ it is not advocating that costs allocation and monitoring should be carried out at the level of individual ratings. However, ESMA expects all CRAs to consider the following good practices observed:



Costs are monitored and allocated at a level of granularity consistent with the established fee schedules (for example by asset class, product or service, geographic area)

Costs are monitored by different categories: direct (analytical time costs) versus indirect (support functions, overheads, marketing), fixed versus variable, tangible versus intangible

Potential costs not fully quantifiable, such as intangible costs are assessed in qualitative terms and taken into account in the fee setting process

2.3.2 Fee setting process

51. ESMA stressed in the Thematic Report that CRAs should establish a price setting process that ensures fees are based on costs and that enables them to demonstrate how the regulatory requirements are met. ¹⁵ ESMA's focus is on ensuring that the outcome of such processes are fee schedules or fee programmes which are cost-based and non-discriminatory and that such fee schedules or programmes are consistently and systematically applied. When deviations from fee schedules or programmes are needed,

¹³ See paragraph 79 and point b) of Paragraph 81 of the Thematic Report


¹⁴ Ibid.

¹⁵ Paragraph 80 and point a) and c) of Paragraph 81 of the Thematic Report of the Thematic Report

these are subject to established criteria, approvals and internal controls to ensure that these are not arbitrary and are applied to clients in a non-discriminatory way (the application of the fee schedule and deviations is covered in section 2.3.3).

52. In line with the findings regarding CRAs' pricing policies set out in section 2.2 on transparency and disclosure, ESMA notes that a good practice is **to establish policies and procedures governing the fee setting process that embed the regulatory requirements** of cost-based and non-discriminatory fees and provide clear guidance as to how these requirements are met. ESMA notes that such approach is not yet consistently followed across CRAs, and that the only standard practice is limited to including guidance on the separation between the commercial and analytical activities of the CRA. As previously noted, this is not sufficient to fulfil all the obligations established by the fees provisions.
53. Another good practice observed by ESMA, was **to strengthen the governance framework in place for the fee setting process** by expanding and diversifying the profiles and roles of those involved, including the composition of the relevant approval bodies and committees. For instance, in addition to involving commercial and business development staff, some CRAs have involved senior people from different functions such as accounting and finance in their fee setting process. These staff members do not have revenue/sales-related responsibilities or objectives and so can provide additional and relevant information, different perspectives and an added layer of scrutiny to fee setting and costs monitoring practices, which improves CRAs' ability to meet the regulatory requirements of establishing cost-based and non-discriminatory fee schedules and programmes.
54. On reviewing CRAs' fee schedules and programmes, ESMA observed as a good practice instances where **CRAs have directly and explicitly linked the fee schedules or programmes to cost components**. In the more advanced examples seen by ESMA, the fee schedule includes an explicit association to direct analytical and production costs as well as to other categories of cost which are identified as key components of the CRA's pricing model (such as overheads or marketing costs) and target margins.
55. However, ESMA notes that the inclusion of costs factors should not be used as a means of developing artificially wide ranges of permissible fees. This may occur in cases where clients can be charged fees that vary significantly between the minimum fee, where only direct costs are recovered, and the maximum fee, where all costs are recovered plus the desired margin. It is important for CRAs establishing relatively broad fee ranges to ensure that such fee ranges are justified by CRAs' costs, so that the potential price flexibility allowed in theory by the fee range does not ultimately result in price discrimination when the fee schedule is applied in practice.
56. In ESMA's view, establishing and formalising policies, procedures, standards and guidelines which embed the regulatory requirements on cost-based and non-discriminatory fees would also facilitate increased monitoring and oversight of the fees provisions by compliance and internal audit staff throughout the fee setting and costs monitoring process, from the initial phase of setting the fee schedules or programmes to the final phase of applying them and charging fees to clients which are cost-based and non-discriminatory.

57. In the table below, ESMA summarises the good practices it supports and that, in line with previous considerations, are either already implemented by some CRAs or supported by ESMA as possible further improvements:


<i>The fees related documentation framework of policies, procedures, standards and guidelines embed the regulatory requirements on cost-based and non-discriminatory fees</i>
<i>The fee setting process is formalised and the activities conducted are documented, including how costs and other factors are considered so that costs are a key pricing factor</i>
<i>The fee setting governance framework and approval process involves different staff from across the CRA including senior staff without revenue/sales responsibility and/or objectives</i>
<i>The established fee schedules include considerations of CRAs' cost factors, including details of the relationship between the fees listed and their cost components</i>
<i>When fee schedules allow for wide fee ranges, these are justified by CRAs' cost structure and do not result in discriminatory pricing</i>
<i>Active involvement of compliance and internal audit in regular and in-depth reviews of the end-to-end fee setting and costs monitoring process</i>

2.3.3 Application of fee schedules/programmes and price deviations

58. ESMA's Thematic Report pointed to weak processes and controls over how fee schedules and fee programmes were applied by CRAs, in particular with regard to deviations from these.¹⁶ Weak processes and controls over deviations from fee schedules or programmes increase the risk of arbitrary pricing and that fees charged are not cost-based and non-discriminatory.


59. ESMA notes that following the publication of the Report, several CRAs tested and re-assessed their processes regarding fees which deviate from fee schedules and programmes, including as a result of internal audits carried out at ESMA's request.

60. CRAs identified some important findings from these audits. For instance, one CRA identified that only one third of the fees charged were aligned with the currently applicable fee schedule in a specific asset class, because the contract renewal process did not take into account the revised fee schedule. CRAs also identified weaknesses in their processes for approving and documenting exceptions to the application of the fee schedule, including a lack of appropriate checks before granting exceptions and a lack of ongoing monitoring and validation of outstanding exceptions. Those findings have led CRAs to improve their

¹⁶ See paragraph 31 of the Thematic Report. See also Paragraph 73 of the Thematic Report.

practices to ensure that they adopt a more disciplined approach, in particular as regards the discount criteria and use of exceptions, the process of approving exceptions, the reporting and documentation requirements in place as well as the applicable governance framework and the involvement of the control functions in the monitoring and oversight of the fees process.

61. ESMA summarises the good practices identified in the table below:


<i>Clear and objective criteria for granting deviations from fee schedules are formalised and documented</i>
<i>All discounts and deviations from fee schedules are recorded together with the reasons why they were granted</i>
<i>The governance framework and approval process for granting deviations from fee schedules is formalised and documented</i>
<i>Documented deviations from fee schedules are reported to senior management and/or the relevant committee and are subject to ongoing monitoring</i>

2.3.4 Controls over CRAs' fee setting and costs monitoring processes

62. ESMA's Thematic Report and this Follow-up Report highlight the importance for CRAs of establishing appropriate controls over their fee setting and costs monitoring processes to ensure that fees charged are cost-based and non-discriminatory. ESMA expects CRAs to ensure that these controls are comprehensive and effective. In ESMA's view, this means that the controls over CRAs' fee setting process should include not only monitoring by commercial staff and managers, but also by the CRAs' Compliance and Internal Audit functions. In order to ensure the effectiveness of these controls, CRAs should monitor how the controls put in place work in practice and ensure compliance with the requirements of the CRAR.


63. ESMA has already highlighted in this Follow-up Report certain examples of good practices with regards to the role of the Compliance and Internal Audit functions in such monitoring. ESMA has also highlighted how the implementation of some of the other good practices identified would also indirectly contribute to enhancing the role and effectiveness of the Compliance and Internal Audit functions in performing their duties.

64. ESMA welcomes the enhanced role of the Compliance function as regards the monitoring of price deviations, including regular reporting and compliance checks, as well as over the end-to-end fee setting and costs monitoring processes to ensure that the fee schedules are established and applied in compliance with the cost-based and non-discriminatory requirements of the fees provisions.

65. As regards the Internal Audit function, as mentioned in the introduction and in section 2.3.3 above, some CRAs conducted an internal audit to assess how their fees setting and costs monitoring processes met the regulatory requirements of CRAR in line the expectations set out in the Thematic Report. These audit reports were very informative and often identified findings which required action by CRAs' management in areas

including disclosure to and communication with clients; reporting to ESMA; of the need for greater consistency and/ transparency within the fee setting process and supporting documentation, in particular as regards negotiating and recording deviations from fee schedules or fee programmes.

66. ESMA identified that the most effective internal audits were those where the stated objective of the audit was to assess the effectiveness of the CRA's processes and controls against the specific expectations about cost-based and non-discriminatory pricing set out in the Thematic Report. In contrast, ESMA found that the least effective and intrusive audits had been limited to merely assessing the conformity of internal processes with actual fees setting and costs monitoring practices, without considering whether those processes effectively achieved the regulatory objectives of cost-based and non-discriminatory pricing. In ESMA's view, if the audit activity does not take into account the regulatory objective it risks underestimating, or failing to identify, material deficiencies in the established processes and controls.
67. In the table below, ESMA summarises the good practices it supports and that, in line with the considerations included across the entire section 2 on CRAs, are either already implemented by some CRAs or supported by ESMA as possible further improvements:


<i>Establish and/or enhance a fees-related documentation framework of policies, procedures, standards and guidelines which embed the regulatory requirements and reflect ESMA's expectations</i>
<i>Implement appropriate control activities at the fees process level to minimise the risk of errors and of implementing processes which are not compliant with the regulatory requirements</i>
<i>Enhance the role of the Compliance function in monitoring compliance with regulatory requirements and ESMA's expectations for example through reviewing regular reporting of price deviations</i>
<i>Embed a more compliance-oriented culture within the practices of CRAs' commercial functions, including through providing training for Commercial staff regarding the implementation of the regulatory requirements on fees</i>
<i>Enhance the role of the Internal Audit function in monitoring the effectiveness of the controls in place over fee setting and costs monitoring processes</i>

68. The above-mentioned practices and areas of possible further improvements are driven by supervisory observations in the area of fee setting and costs monitoring processes across CRAs. More generally, in line with ESMA's 2019 Work Programme,¹⁷ ESMA has launched a Consultation Paper on Internal Controls for CRAs in order to provide guidance on what ESMA considers an effective internal control system within a CRA.¹⁸

¹⁷ See ESMA's Supervision – 2018 Annual Report and 2019 Work Programme, 19 February 2019 ESMA80-199-273, published at: https://www.esma.europa.eu/sites/default/files/library/msp_ar2018_and_wp2019.pdf

¹⁸ See Consultation Paper - Guidelines on Internal Controls for CRAs, 5 December 2019 ESMA33-9-355, published at: https://www.esma.europa.eu/sites/default/files/library/esma_33-9-355_consultation_paper_for_internal_control_guidelines.pdf

2.4 Access to and use of credit ratings

69. In its Thematic Report, ESMA set out the end-to-end rating process and explained that some entities related to CRAs are monetising credit ratings using a number of different business models simultaneously. The largest groups of CRAs operating in the EU are able to do this by selling individual credit ratings to issuers as well as by licensing credit ratings to subscribers through data feeds distributed by their information services companies. ESMA notes that the information services companies of the three largest CRAs operating in the EU were established between 2004 and 2008, prior to the entry into force of the CRAR in 2009.
70. In the Thematic Report, ESMA expressed concerns related to the distribution of credit ratings and related products and services such as research when this is carried out by information services companies within the CRAs' groups. ESMA highlighted that the lack of oversight of these activities by either the CRA or by ESMA could create risks for the wider community of investors, given that these credit ratings and related research are used to comply with regulatory obligations, for example under the Capital Requirements Regulation and Solvency II. They are also used by companies, banks, asset managers and insurers to calculate risks and exposures and to drive investment decisions as well as for external client reporting.
71. ESMA committed to conduct follow-up work with CRAs, information services companies and their clients to improve its understanding of the credit rating related products and services provided by information services companies as well as the fees charged and costs associated with providing these services. As a part of this process, ESMA conducted research on how the credit ratings issued by some of the largest CRAs could be used in practice and obtained further information from users of credit ratings and CRAs. ESMA also requested information from information services companies related to CRAs about their business practices, including how credit ratings are licenced, how licence fees are calculated and how costs are monitored. The information services companies affiliated with the three largest CRAs operating in the EU dispute that ESMA has the ability to supervise their activities and so most did not provide full details of their commercial arrangements with CRAs or with their subscribers. However, ESMA would like to highlight the approach adopted by one CRA and the affiliated information services company as they did comply with ESMA's request for information under the CRAR by sharing the commercially sensitive information requested about their fees and costs.
72. Following the publication of the Thematic Report, ESMA has observed that the commercial practices of the information services companies affiliated to CRAs have not changed significantly. ESMA has continued to receive complaints from users of credit ratings about the terms and conditions of the licences that users are required to enter into in order to be able to access and use credit ratings.¹⁹ ESMA presents these complaints below and highlights two positive initiatives taken by the largest CRAs and one information service company in response to concerns raised by users of credit ratings and by ESMA. Although ESMA welcomes these initiatives, it remains concerned that they are not

¹⁹ ESMA notes that similar concerns have been raised by market data users regarding the licensing conditions, and the fees charged for access to and use of trading and other market data. ESMA is considering these concerns as a part of its current MIFID Review of market data costs. See ESMA70-156-1065 Consultation Paper MiFID II/MIFIR review report on the development of prices for pre- and post-trade data and on the consolidated tape for equity instruments, 12 July 2019.

sufficient to address the risks to investors posed by the distribution of credit ratings to subscribers through information services companies.

73. In 2018, ESMA carried out research into the terms of use of the credit ratings published on the websites of a sample of three of the largest CRAs operating in the EU and two smaller CRAs. ESMA found that although users of credit ratings could view credit ratings published on the websites of the three largest CRAs operating in the EU, at that time nearly all of these CRAs' terms of use prohibited the use of information retrieved from the CRAs' websites for internal or external business purposes.²⁰ In order to download information about credit ratings or to use a credit rating for internal or external business purposes, including client or regulatory reporting, a user needed to subscribe to a licence agreement with the information services company within the CRA's group to access credit ratings data feeds.
74. Data feeds are streams of data, including credit ratings, in some cases bundled together with other types of market data and analysis. They are provided in machine readable format and are directly integrated into users' internal operating systems. The credit ratings in these data feeds may be automatically updated, or updated on a daily or monthly basis, depending on the type of licence purchased.
75. Users of credit ratings cannot avoid entering into these licences if they wish to use credit ratings, as even where they access the CRAs' credit ratings through a third party provider of market information, they are still required to enter into a licence with the CRA's information services company if they wish to do more than simply view credit ratings through these third party platforms.
76. Users of credit ratings have reported that the licences to use credit ratings that they obtain from information services companies are subject to renewal every year and that there is little or no scope to negotiate the terms of these licence agreements, particularly as regards fees. Users of ratings also reported a lack of transparency around pricing models and fee increases. They explained that they are notified of increases in fees every year but are not routinely presented with individual product prices in advance of discussions about the terms of their licence renewal.²¹ Some users of ratings have reported that information services companies threaten to suspend access to credit rating data feeds which are critical to their businesses if they do not agree to the fee increases proposed.²²
77. When asked about data usage changes, users of credit ratings explained to ESMA that the information services companies affiliated to CRAs require them to complete user questionnaires to provide them with information about:
 - a) the size of their business (such as the amount of assets under management);
 - b) the number of individual users accessing the service in each office;
 - c) the number of ratings downloaded;
 - d) the number of ratings used in client reports; and

²⁰ DBRS Ratings Limited did not restrict the use of ratings information. They do not offer a data feed product in the EU. Moody's did allow printing and downloading on an occasional and irregular basis solely for internal business use at this time. AM Best Europe Rating Services Ltd also allowed internal non-commercial use within an organisation on an occasional and irregular basis at this time.

²¹ EFAMA and BVI submission regarding Guidelines on Periodic Information. Responses to the Consultation Paper on Guidelines on Periodic Reporting by CRAs, published at: <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-responses-its-consultation-revised-guidelines-periodic-reporting>

²² EFAMA submission regarding Guidelines on Periodic Information.

e) the number of ratings used in regulatory reporting.

78. Once users of credit ratings have completed these questionnaires, the information services companies will determine which types of licence and how many licences are required by the user. However, this process is not transparent, and users have complained that following completion of user questionnaires, they frequently find that they are required by the information services companies to enter into additional licences, and therefore pay additional fees, to cover their existing usage. One of the information services companies contacted by ESMA did recognise that there may be situations where high fee increases are levied, *'where there are changes in terms of usage'* but stressed that this would only happen in exceptional circumstances, such as where two companies merge.
79. ESMA found that the information services companies affiliated with all of the three largest CRAs' had in recent years started to require additional licences to be entered into by clients who need to use credit ratings in regulatory reporting under Solvency II. The information services companies required these additional reporting licences to be purchased even if the client had already subscribed to a licence to use credit ratings. One information services company has since clarified that no additional fees would be charged to customers for this separate reporting licence if they are already paying for a credit ratings data licence. ESMA calls on the other information services companies affiliated with CRAs to adopt this approach.
80. ESMA has strongly encouraged CRAs to reassess their practices regarding access to and use of credit ratings to ensure that regulatory reporting can be carried out by users of ratings without the need to enter into a licence with their information services companies. The 3 largest CRAs operating in the EU have all stressed that they have an arms' length relationship with the information services companies in their group. They state that they accept no responsibility for the quality or accuracy of the products distributed by their information services companies and have no oversight over the policies and procedures in place or the fees charged for their credit ratings related products and services.
81. However, in response to concerns raised by ESMA about access to and use of ratings, the three largest CRAs operating in the EU have all agreed to make changes to the terms of access to the credit ratings published on their websites. These terms of use are now being modified to ensure that users of ratings can use credit ratings published on their websites for internal purposes and/or for regulatory reporting going forward. ESMA welcomes this development and calls on all CRAs operating in the EU to ensure that these uses of credit ratings are not restricted.
82. Despite these positive initiatives, ESMA remains deeply concerned that the distribution of credit ratings through data feeds is not being carried out by the CRAs themselves but by the information services companies within the CRAs' groups. In order to ensure the quality and independence of credit ratings, the CRAR was designed so that only credit ratings issued or endorsed by registered CRAs could be used in the EU for regulatory purposes.²³ The distribution of credit ratings to subscribers by companies which are not registered to provide credit ratings in the EU raises both competitiveness and investor protection concerns for ESMA.

²³ See Recital 1 and Article 2(1) and Article 4 CRAR.

83. From a competitiveness perspective, where some CRAs distribute credit ratings to subscribers through information services companies this may result in the unequal treatment of CRAs under the CRAR, for example when calculating CRAs' market shares as required by Article 8d of the CRA Regulation ²⁴ or when calculating supervisory fees charged by ESMA. ²⁵ It is not possible for ESMA to promote equal conditions of competition for CRAs operating within the EU if it supervises the distribution of credit ratings to subscribers when this is carried out by CRAs but not when this is carried out by other firms within CRAs' groups.
84. This approach also raises concerns from an investor protection perspective. ESMA takes the view that users of credit ratings in the EU should be confident when they purchase credit ratings that these are sold to them in accordance with the provisions of the CRAR regarding the quality, accuracy and timeliness of credit ratings as well as in accordance with the provisions relating to fees. Through their complaints to ESMA, users of credit ratings have made it clear that they expect the CRA and ESMA to be supervising the distribution of credit ratings, irrespective of which part of the CRA's group is carrying out these activities.
85. ESMA notes that not all CRAs distribute credit ratings through separate companies. Given the risks highlighted above, ESMA is of the view that CRAs should be clearly responsible for the distribution of the credit ratings they produce. For instance, this could be achieved if credit rating distribution was carried out by the CRAs themselves or, when offered by the related companies, it would be covered by formal outsourcing arrangements.
86. On the basis of its follow up work ESMA has identified the following good practices which it expects all CRAs and their information services companies to consider:



The terms of use of CRAs' websites allow credit ratings and rating announcements to be downloaded for internal purposes and regulatory reporting

Customers of information services companies affiliated to CRAs not charged additional licence fees for the use of credit rating information for regulatory purposes

87. ESMA will monitor the implementation of changes to the terms of use of credit ratings published on CRAs' websites and will continue to work on improving access to and use of credit ratings.

²⁴ As highlighted in paragraph 332 of ESMA/2015/1472 Technical Advice on Competition Choice and Conflicts of Interest in the CRA Industry.

²⁵ European Court of Auditors' Annual report on EU agencies for the financial year 2018, 15 October 2019, published at https://www.eca.europa.eu/Lists/ECADocuments/AGENCIES_2018/AGENCIES_2018_EN.pdf. 'Other matter' paragraph 3.13.6 states: 'The fees charged to credit rating agencies are based on their revenue as legal entities, but not as a group or group of related entities. This creates a quasi-legitimate opportunity to reduce or avoid fees by transferring revenues from credit rating agencies under EU jurisdiction to their related entities outside the EU. The likely financial effect of this loophole in the regulations is unknown. While the Authority has correctly applied the Regulation, it identified the risk and addressed it to the Commission. The Authority should continue the discussion with the Commission in order to agree the necessary modifications.' Paragraphs 2.13 and 2.44 also provide similar considerations to paragraph 3.13.6.

3 Trade Repositories

88. The Thematic Report focused on TRs' established practices and set out ESMA's key supervisory concerns and expectations on the areas of: transparency of fee schedules, fee setting and cost monitoring. It also aimed at clarifying ESMA's expectations regarding the EMIR requirements that the fees charged for services provided by TRs are publicly disclosed and cost-related and that access to TR services is non-discriminatory.²⁶
89. Following the publication of the Thematic Report, ESMA continued its engagement with TRs and monitored their follow-up actions in the area of fee setting and cost monitoring. ESMA's follow-up work aimed at verifying whether TRs acted upon the findings set out in the Thematic Report and adjusted their practices to meet ESMA's expectations.
90. As part of its follow-up work ESMA discussed the Thematic Report's findings with most registered TRs, reviewed relevant board minutes, compliance reports and internal audit reports submitted to ESMA since January 2018 and assessed notifications of material changes relating to fee schedules and pricing policy changes received between January 2018 and August 2019. ESMA also sent letters to TRs requesting additional information about the actions implemented or planned to be implemented in future. In certain cases, where no changes were foreseen, ESMA recommended that the TRs in question carried out an independent review of how their existing practices met the regulatory requirements and the expectations set out in the Thematic Report.
91. ESMA notes that following the publication of the Thematic Report awareness of the fees provisions has increased across TRs. Some TRs used the clarifications provided in the Thematic Report to revise their fee schedules and some TRs conducted internal audits to assess how their fee setting and costs monitoring processes met the regulatory requirements.
92. The sections below provide an overview of the actions and good practices that ESMA has identified during its follow-up work. For the convenience of the readers of this report, at the end of each section ESMA provides a list of TR practices that it supports.
93. ESMA encourages TRs to continue implementing or to adopt the good practices identified. However, ESMA also wishes to highlight areas where TRs have not yet met the expectations outlined in the Thematic Report in the area of transparency of fee schedules, fee setting and cost monitoring.
94. Before analysing changes in TRs' practices, it is important to note that the competitive, political and regulatory environment of TRs has also evolved since the publication of the Thematic Report in January 2018.

²⁶ EMIR Article 78(8): "A trade repository shall publicly disclose the prices and fees associated with services provided under this Regulation. It shall disclose the prices and fees of each service provided separately, including discounts and rebates and the conditions to benefit from those reductions. It shall allow reporting entities to access specific services separately. The prices and fees charged by a trade repository shall be cost-related";
EMIR Article 78(7): "A trade repository shall have objective, non-discriminatory and publicly disclosed requirements for access by undertakings subject to the reporting obligation under Article 9. A trade repository shall grant service providers non-discriminatory access to information maintained by the trade repository, on condition that the relevant counterparties have provided their consent. Criteria that restrict access shall only be permitted to the extent that their objective is to control the risk to the data maintained by a trade repository."

95. In particular, there were changes in the ownership of some TRs, two new TRs were registered in early 2019²⁷ and one TR was deregistered. This means that there are currently 9 TRs registered with ESMA, as shown in the table below:

Table 2: EU registered TRs and their ownership as of September 2019

ESMA registered TR:	TR Location	The ultimate owner:
CME Trade Repository Ltd. (CME TR)	UK	CME Group Inc., US
NEX Abide Trade Repository AB (NATR)	SE	
DTCC Derivatives Repository Plc (DDRL, previously DTCC Derivatives Repository Ltd.)	UK	The Depository Trust & Clearing Corporation (DTCC), US
DTCC Data Repository (Ireland) Plc	IE	
ICE Trade Vault Europe Ltd. (ICE TVEL)	UK	Intercontinental Exchange, Inc.
Krajowy Depozyt Papierów Wartościowych S.A. (KDPW)	PL	National Bank of Poland, Ministry of Treasury of Poland, Warsaw Stock Exchange
REGIS-TR S.A.	LU	BME (ES) and DBAG (DE)
UnaVista Limited	UK	London Stock Exchange Plc
UnaVista TRADEcho B.V.	NL	

Source: ESMA elaboration based on TR registration information

96. As nearly half (four) of ESMA's registered TRs are based in the UK, more changes in the TR industry will be triggered following the UK's exit from the EU. Under EMIR,²⁸ counterparties shall ensure that the details of any derivative contract they have concluded are reported to a TR registered with ESMA or a TR recognised by ESMA.²⁹ In the event that the UK leaves the EU, UK-based TRs will lose their registration with ESMA and EU 27 counterparties who currently report to UK-based TRs will need to find an alternative EMIR compliant reporting solution.

97. It is therefore possible that clients will start migrating more actively from one TR to another in future. In this context, the transparency of TRs' fee schedules, cost-related fee setting

²⁷ The new registrations are part of contingency planning of the groups owning UK-based TRs in preparation for the event that the UK leaves the EU

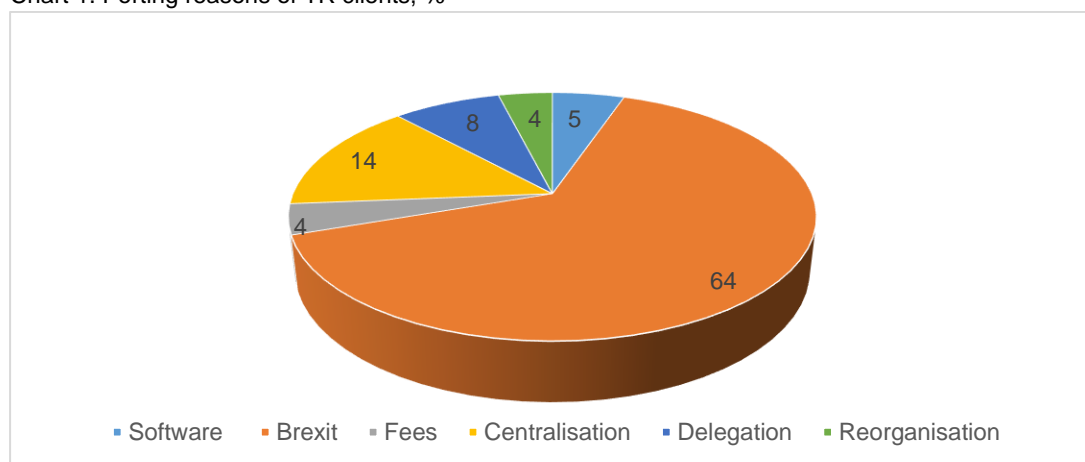
²⁸ EMIR Article 9 – Reporting obligation

²⁹ There is no TR recognised by ESMA so far

and non-discriminatory access become all the more critical, as clients will need to be able to review these to make informed decisions regarding the selection of EU-27 based TRs so that they can continue to meet their reporting obligations.

98. ESMA’s Guidelines on the transfer of data between trades repositories³⁰ (Guidelines on Portability) may assist in this process. The purpose of the Guidelines on Portability is to remove obstacles to switching TRs so that TRs’ clients can benefit from the multi-TR environment but also to make sure that the transfer of data between TRs is conducted in a consistent and harmonised way to allow for continuity of reporting and reconciliation without having a negative impact on the quality of data available to authorities.
99. To develop greater insights into the reasons why clients might wish to transfer their data from one TR to another, ESMA has asked TRs to provide information about the clients who expressed an interest in transferring data into or out of the TR. With the caveat that for 30% of clients the reason is unknown, the statistics indicate that the majority of client portability initiatives was being driven by concerns about the UK leaving the EU (64%).³¹
100. The intention of clients to centralise their reporting under different regulatory regimes to one TR was the second biggest driver of porting (14%). Interestingly, 8% of clients who expressed an interest in porting were considering delegating their reporting to a service provider instead of contracting with a new TR. 5% of clients intended to port following the change of software that is used by the client for reporting. 4% intended to port for organisational reasons, for example in case the business had been sold to a company reporting to another TR.
101. For only 4% of clients, the key driver of porting initiatives was the fees charged by TRs. However, it is also likely that, while not being the primary driver of clients’ decisions, the fees charged by TRs may also have played a role in cases driven by reporting centralisation, reporting delegation or business re-organisation.

Chart 1. Porting reasons of TR clients, %



Source: ESMA calculation based on porting statistics provided by TRs, August 2019.

³⁰ See Guidelines on transfer of data between Trade Repositories; 27 April 2018 ESMA70-151-1116, published at: https://www.esma.europa.eu/sites/default/files/library/esma70-151-1116_guidelines_on_transfer_of_data_between_trs.pdf


³¹ The statistics included TR provided information about the clients who expressed interest/requested to port in and port out across all TRs since the implementation of the Guidelines on Portability up to August 2019. For the purpose of the analysis, any duplicates (where one TR reported information about a client that intended to port in and another TR reported information about the same client that intended to port out) were eliminated.

3.1 Transparency of fee schedules

102. In the Thematic Report, ESMA highlighted that sufficient transparency can be achieved by using clear, comparable, consistent and comprehensive fee schedules that enable a client to estimate its total costs of reporting to a TR.³² ESMA pointed to the different levels of detail and the different definitions used in TRs' fee schedules which made it hard to compare them and work out the full cost of becoming or remaining a client. ESMA recommended that TRs should provide more explanatory information, use clear definitions that are commonly understood within in the industry, and consider developing fee calculators which could be published on TRs websites to help clients and prospective clients understand the fees charged for trade reporting.
103. Overall TRs were receptive to ESMA's views on transparency. Following the publication of the Thematic Report, a majority of registered TRs introduced updates to their public fee schedules. The updates vary from revising reporting fees and fee caps to clarifying the definitions used, to making changes to the layout of their fee schedules in order to make the content clearer and more accessible. When the Guidelines on Portability entered into force some of the TRs also introduced and published specific porting fees.
104. ESMA also noted that most TRs increased their outreach to clients to support greater transparency:
- a) In particular, one TR reported that clients' concerns, ideas and suggestions regarding the transparency of its fee schedule were discussed in a specific workgroup and that any future amendments to the fee schedule will be discussed with the clients in order to ensure transparency.
 - b) One TR provided specific examples of how their fees were amended following consultation with market participants on their clarity and structure. Another TR explained that they took on board market participants' feedback on prior versions of the fee schedule to clarify their updated fee schedule.
 - c) One TR explained that it gives advance notice to clients of any changes to the fees that it charges so that clients' questions regarding the fee schedule can be answered before the revised fee schedule is implemented.
 - d) One TR used a client survey that included a fee-related question. In this regard, ESMA expects that client surveys containing fee-related questions are structured in a way that allows them to collect detailed feedback on the transparency of their fee schedule, rather than simply asking clients to rate or to rank their satisfaction with the fees that the TR is charging as a part of an overall customer satisfaction survey.
105. ESMA also notes that one TR seems not to engage pro-actively with clients to enhance its transparency standards but has only reacted to queries from existing, new or prospective clients. ESMA believes that this passive approach ignores a valuable source of information that could help to ensure that their fee schedule is transparent and regularly monitored.

³² Page 34 of the Thematic report of 11 January 2018

106. Further, ESMA found that one of the TRs mainly relies on input from the members of the Board who give their approval prior to fee schedules being published or amended. Although some of the members of the Board represent users of the trade repository, ESMA considers that this practice is insufficient as it does not capture the potential views of other types of market participants not represented on the Board.
107. ESMA expects TRs to be pro-active in seeking customer feedback and encourages TRs to reach out to clients in a non-selective way. Similarly, ESMA encourages TRs' clients to be pro-active and inform TRs where they find that fee schedules are not clear and complete or are inconsistent or incomparable with the fee schedules of other TRs.
108. Finally, as an area for improvement, ESMA expects that the compliance function of the TRs monitors fee transparency and plays a role in helping to ensure that the relevant improvements to fee schedule transparency are identified and implemented in a timely manner.
109. ESMA summarises the good practices identified and further areas for improvement in the table below:

 <i>Pro-actively seeking customer feedback from all categories of TR clients, for example through targeted surveys</i> <i>Sufficient notice given to TR clients in advance of fee schedule updates</i> <i>Publication of all types of fees, including porting fees and connectivity fees (if any)</i>

3.2 Costs monitoring and fee setting

110. In the Thematic Report, ESMA emphasised that it is important to ensure that TRs' decisions about price setting are based not only on strategic and/or practical considerations but also that TRs must be able to demonstrate that their fees and fee caps are driven by costs.³³ ESMA found that TRs had not made sufficient efforts to ensure that the fees charged were costs related. It encouraged TRs to set their fees using costs as a key pricing factor, to break down their costs to the level of services provided, to ensure regular reviews of costs and to ensure that intra-group transactions are carried out on reasonable terms in accordance with the arm's length principle.


3.2.1 Cost-related fees

111. Following the publication of the Thematic Report, ESMA observed that some TRs introduced new pricing policies or revised their existing pricing policies so that they provide a clear pricing framework and include the key principles that TRs apply when setting fees. In ESMA's view, such enhanced policies help TRs to comply with the fees related provisions of EMIR.
112. ESMA noted that one TR established a position dedicated to managing the TR's pricing activities. ESMA acknowledges that this may be particularly helpful in case of TRs

³³ Page 35 of the Thematic Report

operating as part of complex organisational or group structures. In ESMA's view, having such a role can help in the development of pricing practices and that the centralisation of knowledge and development of expertise in this area would greatly help to ensure the correct and uniform application of the relevant fees provisions.

113. Most of the TRs stated that they undertake regular reviews of costs, some as frequently as monthly. For example, one of the TRs stated that in order to ensure that the fee setting process remains cost-related, both the direct and indirect costs of providing TR services are analysed during monthly finance review meetings. However, in most cases ESMA did not see evidence of TRs' costs reviews being discussed in depth or being challenged by TRs' senior management or relevant approval bodies. ESMA takes the view that TRs' costs reviews are still too high-level as they mainly focus on overall profitability at income statement or at business level rather than on the cost-relatedness of fees for the relevant services provided, as required by EMIR.
114. One TR reported that it has no plans to change its approach to cost monitoring in line with the findings of the Thematic Report because many of its functions are outsourced to the group, which makes cost allocation complex. ESMA does not agree that an operating model which entails significant outsourcing to the group prevents a TR from improving its cost monitoring practices. Registered TRs are responsible for carrying out the cost monitoring activities needed in order to demonstrate that their fees are cost-related and this obligation cannot be transferred to other companies within a TR's group.
115. Following a request from ESMA, one TR carried out an internal audit which identified that the TR needs to improve the way in which it documents its cost monitoring activities and how it assesses the cost-relatedness of fees. ESMA welcomes these findings and notes that correctly documenting existing practices allows for greater oversight of the TRs' compliance with the fees related provisions of EMIR, both by staff involved in pricing, managers approving pricing and the internal control functions reviewing the compliance of pricing practices with the fees provisions of EMIR. ESMA encourages more active involvement of TR internal control functions (Compliance and Internal Audit) in the assessment and monitoring of TRs' fees and costs.
116. ESMA summarises the good practices identified and further areas for improvement in the table below:

 <i>Pricing policy in line with EMIR requirements and ESMA's expectations</i> <i>Dedicated staff member responsible for overseeing TR pricing, especially in TRs with complex organisational and group structures</i> <i>Regular, documented costs reviews</i>
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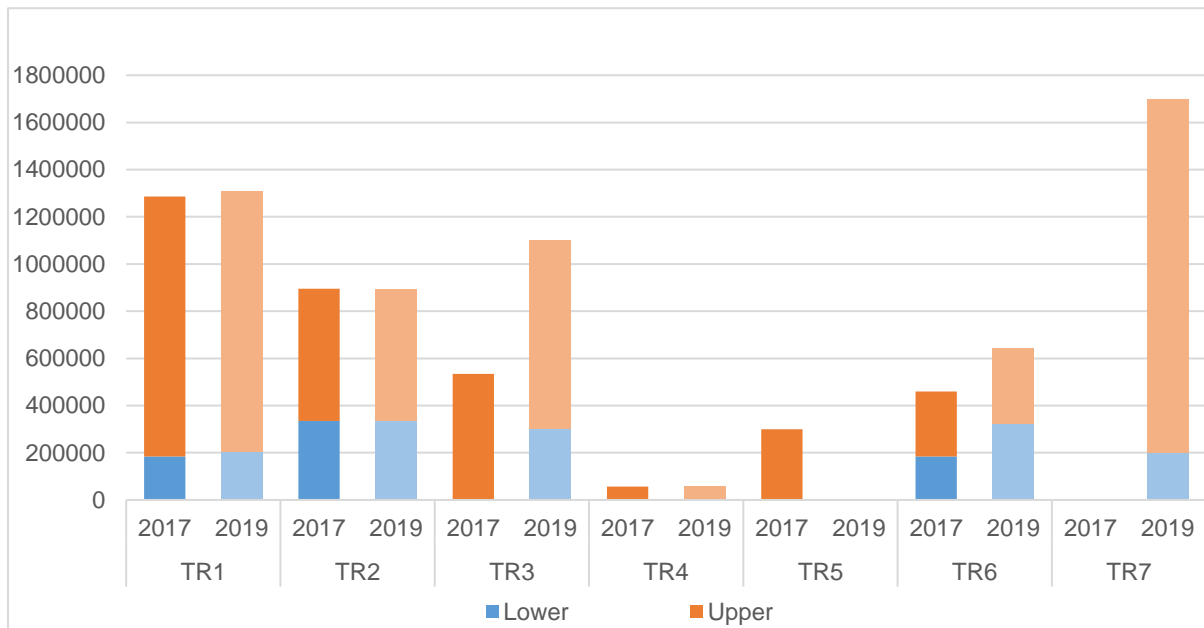
3.2.2 High reporting volume pricing

117. In the Thematic Report ESMA encouraged TRs to regularly monitor and assess how fee caps and volume tiers relate to costs, considering the type, size and activity of reporting firms and their underlying clients. ESMA emphasised the need for TRs to set up

any fee caps used in a way that is non-discriminatory. ESMA identified potential risks of non-compliance with the fees provisions in cases where no information is available about the volume attributed to each of the reporting client's underlying counterparties or cases where fee caps were being applied to only a relatively small proportion of TR clients, in particular where these clients belong to the same group as the TR itself.³⁴

118. Since the publication of the Thematic Report, some of the TRs have revised their fee caps. Chart 2 provides an overview of the level of fee caps across TRs in 2017 and in 2019.

Chart 2. Fee caps by TR, EUR, 2017-2019³⁵



Source: ESMA elaboration based on TRs' publicly available fee schedules as of October 2017 and as of August 2019.

119. The key changes implemented by TRs were:


- Introducing sliding scale fees which decrease with the increase of reporting volumes instead of a fixed fee cap. Sliding scale fees are designed to capture existing economies of scale for the TR resulting in lower costs per transaction in the larger volumes reported. In ESMA's view, these fees are more cost-related and less discriminatory than fixed fee caps that result in reporting that is free of charge beyond a certain volume;
- Differentiating fee caps for over the counter (OTC) derivatives and exchange traded derivatives (ETD) trades, which is a good practice where TRs' costs vary per derivative type reported, as it ensures that the fee caps reflect actual reporting costs;
- Removing flat fee caps for service providers and/or applying different fee caps to reflect the needs of different types of clients. In ESMA's view, adjusting fee caps to the specific types of clients helps ensure that fees charged are cost-related.

³⁴ Page 32 of the Thematic report of 11 January 2018

³⁵ For comparability purposes, the chart does not include all registered TRs but focus on those where the information is available for both years: 2017 and 2019. The chart does not include sliding fees scales, only minimum and maximum level of fee caps applied.

Furthermore, removing fee caps for reporting service providers helps to ensure that the intermediaries reporting on behalf of many counterparties do not benefit from different pricing arrangements, as these could be discriminatory if not offered to all clients in a similar position on the same terms.

120. ESMA does not find it a good practice to establish generic or flat fee caps that do not apply equally to all types of clients, as this may incentivise clients to use delegated reporting services rather than direct reporting to TRs. Although EMIR foresees a possibility to delegate reporting of the details of derivative contracts,³⁶ this was designed to assist those counterparties that do not have the knowledge and resources to meet their reporting obligations under EMIR themselves.
121. As mentioned at paragraph 100 of this report, 8% of clients interested in portability were considering delegating their reporting to a service provider instead of contracting with a new TR, so it is possible that more clients will chose to delegate their reporting in the future. In this context, ESMA finds it important to highlight that big intermediaries reporting on behalf of many counterparties may generate additional operational risks that have to be considered and managed by TRs.³⁷ In cases where a TR has few direct clients but many indirect clients reporting large volumes through delegated reporting service providers, there is a risk of overreliance on these service providers, in terms of operational risk or financial sustainability.
122. In light of the concerns raised above, ESMA expects TRs' internal control functions to take a more active role in assessing the cost-relatedness of TRs' fees and fee caps to ensure that they do not create discriminatory access to TR services in practice or result in unmanageable operational risks.
123. ESMA summarises the good practices identified and further areas for improvement in the table below:

 <i>Fees charged on a sliding scale which decrease with the increase of reporting volumes instead of being capped at a fixed level</i> <i>Differentiated fee caps used per product to reflect differences in costs</i> <i>Revise or remove fee caps for reporting service providers in order to ensure that the intermediaries reporting on behalf of many counterparties do not benefit from not cost-related fees resulting in discriminatory access conditions</i>

3.2.3 Controls over TRs' fee setting and costs monitoring processes

124. ESMA has already highlighted in the sections above that it encourages a more active involvement of TRs' control functions in the assessment and monitoring of TRs' compliance with the fees provisions of EMIR. ESMA expects TRs to establish appropriate control activities over the fee setting process and to monitor the effectiveness of the

³⁶ Article 9 of EMIR

³⁷ Article 79 (1) of EMIR

controls established. An enhanced control framework can help TRs to ensure that they charge transparent, cost-related fees which allow for non-discriminatory access to their reporting services.

125. In this regard, ESMA expects the Compliance function to play a more active role in assessing and monitoring the compliance of TRs' end-to-end fee setting and costs monitoring processes. ESMA also expects the Internal Audit function to plan and assess how TRs' processes meet the regulatory requirements and the expectations set out in the Thematic Report. ESMA finds that the most effective audit reviews do not only identify the controls in place but also test them via sampling in order to ensure that policies and procedures are consistently applied in line with the fees provisions of EMIR.
126. ESMA understands that control functions have to plan and prioritise their reviews and assessments on the basis of the proportionality principle following a risk-based approach. ESMA would therefore expect fees related reviews to be prioritised by those TRs that outsource many functions to the group, have more complex costs allocation arrangements or that offer, or intend to offer, other services, for example under the Securities Financing Transaction Regulation (SFTR).³⁸
127. ESMA summarises below the identified areas for improvement on the controls established by TRs over their fee setting and costs monitoring processes:



Enhanced control framework ensuring more active involvement of control functions in oversight of fee setting and costs monitoring process

Active involvement of control functions in monitoring transparency, reviewing pricing practices, assessing fee caps and cost-relatedness of fees

Internal audits of TRs' fee setting and costs monitoring processes identify and test the controls applied

Compliance and Internal Audit prioritise fee-related reviews in those TRs outsourcing many functions to the group or offering multiple services under different regulatory regimes

128. The above-mentioned areas of improvement are driven by supervisory observations in the area of fee setting and costs monitoring processes across TRs. More generally, as foreseen in ESMA's 2019 Work Programme, ESMA will further work on providing public guidance for supervised entities on effective internal control system within a TR.

³⁸ With the approval of the final Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) on reporting under the Securities Financing Transaction Regulation (SFTR) in the European Union's Official Journal (EU OJ) 22 March 2019, TRs registered with ESMA have an opportunity to expand their businesses by applying for the extension for registration under SFTR. Note that the SFTR also requires the fees charged to clients to be transparent and cost-related.

4 Conclusions and next steps

129. ESMA believes this Follow-up Report provides useful clarifications as to ESMA's supervisory expectations in the area of fee transparency, fee setting and cost monitoring.
130. ESMA encourages CRAs and TRs to implement the good practices and to act on the areas for further improvement identified in this Follow-up Report. In particular, ESMA expects each firm to analyse which further actions may be necessary in order to ensure compliance with the regulatory provisions on fees and to implement them accordingly.
131. ESMA will continue to monitor CRAs' and TRs' actions and the changes in practices adopted in response to this Follow-up Report. In particular, ESMA will closely monitor the impact of the good practices identified on CRAs' and TRs' ability to demonstrate compliance with the regulatory requirements and on their clients' ability to understand the key elements of the fees charged and the reasons for any fee increases or deviations from fee schedules.
132. ESMA will also monitor the implementation of the changes proposed to the terms of use on CRAs' websites and will continue to work on improving access to and use of credit ratings.

Annex I Factsheet

Follow-up report on fees charged by CRAs and TRs



Regulatory Principles

- CRAs → cost based and non-discriminatory fees independent from rating or work performed
- TRs → publicly disclosed prices, cost-related fees and non-discriminatory access to TR services

Good practices for supervised firms

Clients may expect



CRAs

- ✓ Published pricing policies
- ✓ Standardised fee schedule and discount criteria provided before fee negotiations
- ✓ Clear explanations of:
 - any fee increases
 - any deviation from fee schedules
 - how fees charged reflect the costs of credit ratings and ancillary services
- ✓ CRAs' websites to allow credit ratings and related announcements to be used for internal and regulatory reporting purposes
- ✓ Customers of information services companies affiliated to CRAs not charged additional licence fees for the use of credit rating information for regulatory purposes



TRs

- ✓ Published fee schedules for all services (including porting and connectivity fees)
- ✓ Advance notice of fee schedule updates
- ✓ Opportunities to provide feedback to TRs on transparency of fee schedules and challenge potentially discriminatory practices, for example through surveys



Supervised firms should consider implementing



CRAs

- ✓ Fee setting documents ensure fees charged (including deviations) are non-discriminatory and based on actual costs
- ✓ Costs monitored by categories and at the same level of granularity as fee schedules
- ✓ Estimates of non-quantifiable costs to be included in the fee setting process
- ✓ Staff training on fee setting and cost monitoring requirements



TRs

- ✓ Fee setting documents ensure non-discriminatory access and cost-related fees
- ✓ Fees charged on a sliding scale which decrease with the increase of reporting volumes instead of being capped at a fixed level
- ✓ Differentiated fee caps used per product to reflect differences in costs
- ✓ Revised or removed fee caps for reporting service providers reporting on behalf of many counterparties
- ✓ Regular, documented costs reviews
- ✓ Dedicated staff member oversees pricing process



Enhanced controls for all supervised firms

Internal control framework oversees the end-to-end fee setting and costs monitoring process:

- Business controls over fees charged
- Compliance function actively monitors and promotes adherence to fee-related regulatory requirements through established work programme
- Internal Audit function tests and assesses the effectiveness of controls over fee setting and cost monitoring processes in meeting regulatory requirements and supervisory expectations

ESMA Next steps

- ✓ Continue monitoring of the changes in practices adopted by CRAs and TRs
- ✓ Further work to improve access to and use of credit ratings