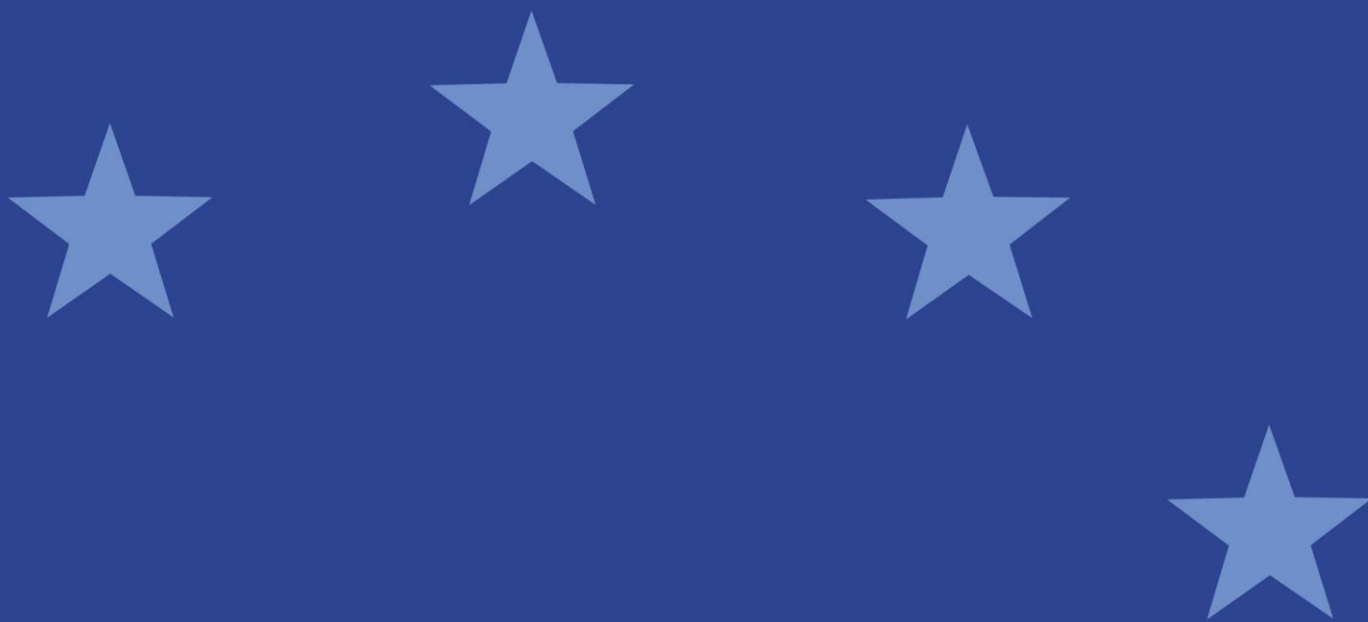




European Securities and
Markets Authority

Consultation Paper

On periodic information to be submitted to ESMA by Credit Rating Agencies



Responding to this consultation paper

ESMA invites comment on all matters in this consultation paper, in particular on the specific questions listed in Annex II. In providing comments, please:

- Respond to the stated questions
- Indicate the question number which the comments relate to
- Where possible, provide quantitative information on any related costs and benefits; and
- Describe any alternative ESMA should consider.

Comments should reach ESMA by 31 October 2014

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 end of the consultation period, unless otherwise requested. Please clearly indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. Note that a confidential response may be requested from us in accordance with ESMA’s rule on access to documents. We may consult you if you receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading [Legal Notice](#).

Who should read this paper?

This consultation paper should be read by credit rating agencies (as defined in Article 3(1)(b) of the CRA Regulation), companies which have applied for registration or are considering applying for registration, competent authorities, and consumer groups.



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Annex II Cost-benefit analysis

Annex III Full list of consultation questions

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Acronyms Used

CEREP	Central Repository for historical performance data of credit rating agencies
CESR	Committee of European Securities Regulators
CRAs	Credit Rating Agencies
CRA Regulation	Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies of 16 September 2009
INED	Independent non-executive director
SOCRAT	Supervision of Credit Rating Agencies Tool, an ESMA internal supervisory tool which CRAs report periodic data on individual rating actions to.

1. Overview

Reasons for publication

1. The European Securities and Markets Authority (ESMA) is the responsible authority for the registration, supervision and policy for Credit Rating Agencies (CRAs) in the European Union. As part of its supervision, ESMA has developed its supervisory and risk framework for credit rating agencies to help focus its thematic investigations and remedial action plans for CRAs on key sector and entity specific risks.
2. In addition to the periodic reporting to CEREP and SOCRAT, registered CRAs must notify ESMA of changes to their initial conditions for registration and submit periodically to ESMA information in accordance with ESMA's Guidance on the enforcement practices and activities¹. CRAs must also submit annually to ESMA information regarding their revenues for the calculation of the supervisory fees and market share. Finally, CRAs submit to ESMA periodically other information that is used for on-going supervisory purposes.
3. Good quality, relevant and timely data is key to the efficient and effective supervision of the CRA sector. This consultation paper seeks stakeholders' views on new supervisory guidelines regarding the information that is periodically submitted to ESMA by credit rating agencies. One of the aims of this consultation paper is to ensure that the information that CRAs are requested to submit to ESMA better reflects ESMA's view of the key risks in the CRA sector.
4. The guidelines are proposed under Article 16 of EU No 1095/2010 of the European Parliament and of the Council of 24 November 2010, which enables ESMA to publish guidelines addressed to financial market participants with a view to establishing consistent, efficient and effective supervisory practices. These proposed guidelines will replace CESR's Guidance on the enforcement practices and activities to be conducted under Article 21.3(a) of the Regulation (ESMA/2010/944) of 30 August 2010.

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5. **Section 2:** Information to be contained in periodic submissions to ESMA. Under Art. 21 (1) of the CRA Regulation, ESMA is required to ensure that the Regulation is applied. To ensure the effective and efficient supervision of CRAs, ESMA proposes CRAs harmonise the level of detail they provide in their submissions of periodic information, and proposes further information that should be submitted as part of this process.
6. **Section 3:** Notifications of material changes to the initial conditions for registration. In accordance with Art. 14 of the CRA Regulation, CRAs must notify ESMA of any material changes to the conditions for initial registration, including the opening or closing of a branch within the Union², without undue delay. The proposed guidelines provide further clarification of what ESMA considers to constitute a material change to the initial conditions for registration.
7. **Section 4:** Calculation of the supervisory fee and CRA market share. Information to be

¹ CESR's Guidance on the enforcement practices and activities to be conducted under Article 21.3(a) of the Regulation (ES-MA/2010/944) of 30 August 2010

² Article 14(3) of the Regulation.



provided in order to calculate ESMA's supervisory fees. In accordance with Art.19 of the CRA Regulation, ESMA shall charge credit rating agencies fees. The proposed Guidelines provide further clarification on what information should be provided by CRAs in order to ensure a more accurate and appropriate allocation of fees.

Next Steps

8. In responding to this consultation, we ask stakeholders to provide quantitative supporting evidence for any views presented. ESMA will consider the responses it receives to this consultation paper in Q3 2014 and expects to publish a final report, and final Guidelines and recommendations by Q1 2015.

2 Information to be contained in periodic submissions to ESMA

Overview

9. The periodic information ESMA receives from CRAs as part of its on-going supervision provides valuable information to ESMA. In addition to the information that ESMA has so far received, ESMA would like to include additional information that will support its on-going supervision. This consultation paper consults only on the additional information it would like to receive. Annex I of the draft Guidelines summarises all information that ESMA will receive periodically from CRAs, including information proposed in this consultation paper.
10. The additional information focuses on key areas of risk in the CRA sector, namely i) business strategy and senior management ii) the control functions in a CRA iii) IT systems and processes.
11. This consultation paper also consults on proposed guidelines providing more information on the detail that should be provided in the submission of information on financial revenues and costs, changes in key positions and staff turnover.
12. The proposed Guidelines incorporate all periodic information that ESMA would like to receive and replace ESMA Guidelines on Enforcement.

2.1 Business strategy, organisational structure and senior management

Overview

13. The Board, senior management and strategy of a CRA are central to its risk profile. The Board and senior management are key to ensuring that a CRA has strong governance and systems and controls in place to meet its ongoing regulatory requirements. The targets put in place to deliver a CRA's strategy and the controls established by senior management will have a significant impact on the quality of the rating process and behaviour of its staff. As part of ESMA's on-going supervision and risk assessments, ESMA needs to have timely and complete information on a CRA's performance, insight into the leadership of a CRA at executive and Board level, a CRA's own assessment of performance and management of risk, and changes to a CRA's senior management.
14. Legal risks can be significant for CRAs and can have a material effect on their risk profile. It is therefore important that ESMA as part of its on-going supervision can assess potential legal risks in CRAs, such as the status of litigation/ proceedings and any new, pending or potential legal proceedings.
15. As well as information on CRAs at a strategic level, ESMA would like CRAs to provide more detailed information regarding possible instances that may result in a breach of the initial conditions of registration. This is to aid ESMA in maintaining the high standards established by the registration process.
16. ESMA also needs to maintain up to date information about CRA's operations in order to provide effective supervision and oversight. For example, ESMA typically requests updated organisational charts where significant staff rotation or changes in key management positions have been identified. ESMA also generally requests copies of organisational charts

following a CRA making a notification of changes to the material conditions for registration and in preparation for ESMA's supervisory actions, such as on-site inspections. As a consequence, registered CRAs in practice regularly send their updated organisational charts to ESMA. ESMA would like CRAs to standardise the submission of organisational charts. The draft guidelines propose that CRAs submit copies of updated organisational charts semi-annually and that the organisational charts should provide sufficient detail to identify the structure of key departments.

17. Regular information on operational performance informs ESMA's assessment of a CRA and the industry at a whole. For this reason ESMA would like to receive information on quarterly revenues and operational and total costs.

Proposed Guidelines

Board minutes, INEDs opinions and reports submitted to the Board

18. CRAs should submit on a semi-annual basis:

- The minutes of the board meetings;
- A copy of documents sent to board members in advance of board meeting as well as the documents discussed in the meeting (for instance, reports made by Compliance, Internal Audit Risk, internal review reports functions, IT strategy);
- CRAs should submit in the semi-annual submission any opinions presented by a CRA's INEDs pursuant to point 2 of Section A of Annex I of CRA Regulation and all reports (including follow-up reports) issued by an independent director.

Legal risks

19. Where the board minutes do not mention the status of litigation/ proceedings concerning the registered CRAs, ESMA should receive semi-annually a full list of pending legal proceedings.

Potential and actual cases of non-compliance with the CRA Regulation that have been identified and measures taken

20. CRAs should provide more detailed information regarding possible cases that may result in a breach of the initial conditions for registration, including:

- a. Descriptions of the possible cases that may result in a breach of the initial conditions for registration;
- b. Identification of the reasons that led to a case which could potentially result in a breach of the initial conditions for registration;
- c. Actions undertaken by the CRA following the identification of a case that may potentially result in a breach of the initial conditions for registration;
- d. An indication of whether an internal investigation has been opened as a consequence, including: status of the investigation (on-going / closed) and where closed, a copy of the relevant report issued (if any).

21. Please note that, where alleged fraudulent or irregular activity (e.g. employee or manager

misconduct) has been identified, or cases that may result in a potential breach of the initial conditions for registration that pose a risk to the integrity and objectivity of existing credit ratings, CRAs should inform ESMA immediately.

Organisational charts

22. CRAs should submit copies of up to date organisational charts. The organisational charts should provide sufficient detail to identify the structure of the following departments (as applicable):

- Compliance function;
- Internal Audit;
- Internal Review function;
- Business lines in charge of ratings activities;
- Information Security function;
- IT department.

Questions

Q.1 Do you agree that ESMA should be kept up to date with changes to a CRA's Board and senior management as described above?

Q.2 Do you agree that receipt of INEDs' opinions will provide ESMA with useful insight as part of its supervisory responsibilities? If not, please explain.

Q.3 Is there further information that the draft guidelines should include on Board minutes and INED opinions?

Q.4 Do you agree that it is helpful in ESMA's supervision of CRAs to receive information on the legal risks that CRAs are exposed to? If not, please explain.

Q.5 Is there further information that ESMA should receive in regards to a CRA's legal risk?

Q6. Are there further possible instances that may result in a potential breach of the initial conditions of registration that should be included in the guidelines as examples?

2.2 Control functions

Overview

23. The quality of a credit rating agency's control functions is an important indicator of the robustness of a CRA's internal control environment and the wider rating process. Information on the workplan of control functions and the assessments/audits performed by control functions informs ESMA not only of the quality of the control functions, but also of a



CRA's own view of its risk profile.

24. ESMA has found it useful to receive information that CRAs' Compliance Departments have received and information on the follow up actions undertaken by CRAs. ESMA proposes to receive this information consistently from CRAs on a quarterly basis.

Proposed Guidelines

Internal complaints submitted to the Compliance Department

25. CRAs should submit to ESMA quarterly:

- A description of the content of the complaint;
- The follow-up actions undertaken by the CRA;
- Information on whether an internal investigation was opened as a consequence, including the: status of the investigation (on-going / closed); where an investigation has been closed, a copy of the internal relevant report issued (if any).

Compliance, Internal Audit, Risk Management

26. CRAs should submit their Compliance work plan. Where a CRA has established an Internal Audit function, ESMA should receive a copy of the Internal Audit updated work plan (where an updated version has been produced during the period).
27. CRAs should submit to ESMA copies of the reports issued by the compliance, internal audit, risk management (covering, for example, operational or information security risks) and review functions. CRAs should provide details of any follow-up action / disciplinary measures undertaken after these incidents or after the conclusion of a review and a copy of any closing report produced. This will aid ESMA in the monitoring of a CRA's own risk management.

Questions

Q7. Do you agree that ESMA should receive CRA's internal audit workplans? If not, please explain.

Q8. Do you agree that the submission to ESMA of follow up actions and disciplinary measures undertaken after internal reviews are a useful way for ESMA to monitor a CRA's risk management? If not, please explain.

Q9. Is there further information that CRAs should submit on receipt of a complaint?

2.3 IT Function

Overview

28. The time critical nature of CRAs' work and their systems dependent processes means that the robustness and resilience of a CRA's IT system is key to the risk profile of a CRA. ESMA has previously expressed concern in a number of public reports regarding the risks posed by the information processing systems (including IT infrastructure). Given the important role of IT in the delivery of timely and accurate ratings, ESMA would like to increase its oversight



of IT operations and risk management.

Proposed Guidelines

IT strategy and governance

29. ESMA should be informed of CRAs' IT strategy and IT work plan, and of changes made to those, so as to be able to monitor more effectively IT risk.

Question

Q10. Do you agree that the submission of CRAs' IT strategy and workplans would aid ESMA in the monitoring of CRA IT risk? If not, please explain.

2.4 Standardisation of the information regarding financial revenues and costs, changes in key positions and staff turnover

Overview

30. ESMA receives periodic information regarding financial revenues and costs, changes in key positions and staff turnover. The aim of the proposed Guidelines is to standardise the periodic information that it receives so that it is easily analysable and comparable.

Proposed Guidelines

Financial revenues and costs (per type of credit rating and on individual and consolidated basis)

31. ESMA should receive information on quarterly revenues per i) type of credit rating and ii) costs. Quarterly revenues should be split across the following types of credit ratings: Corporate Non Financials; Corporate Financials; Sovereign/Public Finance; Structured Finance; Covered Bonds. Quarterly costs should show operational and total costs on a separate basis. Figures should be presented as quarter-on-quarter revenues and costs (rather than year-on-year).

Staff turnover, vacancies and key promotions

32. Quarterly changes in key positions include Lead Analysts and more senior staff (including senior IT management). Changes reported to ESMA should include both new appointments and resignations to help keep ESMA fully up to date with changes in key personnel.

FTE headcount

33. In addition to staff turnover data, ESMA should receive quarterly reports on total staff at CRAs expressed in terms of Full Time Employees.

Questions

Q11. Do you agree that the regular and consistent submission of organisational charts to ESMA contributes to the better supervision of CRAs? If not, please explain.



- Q12. Do you agree with the proposal that ESMA should receive information on quarterly revenues per i) type of credit rating and ii) costs? If not, please explain.**
- Q13. Do you agree with the proposed periodic reporting of changes in key positions and headcount? If not, please explain.**

3. Notifications of material changes to the initial conditions for registration

Overview

34. To register as a CRA within the EU, CRAs must apply to ESMA for registration and demonstrate compliance with the regulation. The registration process requires high standards of governance, systems and controls and rigour in the rating process. In maintaining the quality of registered CRAs, ESMA has a requirement to monitor the registration compliance of a CRA and has powers to withdraw the registration of a CRA where it no longer meets the conditions under which it is registered under Article 20 of the Regulation.
35. In accordance with Article 14 of the CRA Regulation, CRAs must notify ESMA of any material changes to the conditions for initial registration, including the opening or closing of a branch within the Union³, without undue delay. ESMA has in the past clarified in its public guidance⁴, what changes CRAs should consider to be “material”. ESMA considers a “material change” to be a change which may affect the substantive information submitted in the registration application and, more generally, any change that may affect compliance with the requirements of the EU Regulation. The proposed guidance seeks to provide further clarity on ESMA’s expectations in this area, particularly around the reporting of material changes to rating methodologies and changes to IT processes and systems.
36. This section of the proposed guidelines is provided in accordance with Article 21 (1) of the CRA Regulation, which requires ESMA to ensure that the Regulation is applied.

Proposed Guidelines

37. ESMA has previously clarified in public guidance⁵, what changes CRAs should consider to be “material”. ESMA considers a “material change” to be a change which may affect the substantive information submitted in the registration application and, more generally, any change that may affect compliance with the requirements of the EU Regulation.
38. CRAs should notify ESMA of the following material changes (non-exhaustive list):
 - a. Opening and closing of branches;
 - b. Use of endorsement;
 - c. Outsourcing arrangements (including new outsourcing arrangements or changes to existing outsourcing arrangements);
 - d. In the legal form;
 - e. To business combinations (including reorganisation or restructuring of the CRA activities and spin-offs);

³ Article 14(3) of the Regulation.

⁴ Guidelines - Registration Process, Functioning of Colleges, Mediation Protocol, Information set out in Annex II, Information set for the application for Certification and for the assessment of CRAs systemic importance (ESMA/2010/347).

⁵ Guidelines - Registration Process, Functioning of Colleges, Mediation Protocol, Information set out in Annex II, Information set for the application for Certification and for the assessment of CRAs systemic importance (ESMA/2010/347).

- f. Type of business activities (including the provision of new services and launch of new products in both the rating or non-rating business);
 - g. Issuance of new class/type of credit ratings;
 - h. The ownership structure: acquisition or disposal of holdings above 10%;
 - i. Supervisory/administrative board;
 - j. Compliance function (including staff changes) and review function;
 - k. Procedures used to issue and review credit ratings.
39. ESMA also includes the following as examples of material changes it should be notified of:
- a. Material changes to financial resources;
 - b. Changes to the rating methodologies, models or key rating assumptions;
 - c. Major changes in the IT process and information processing systems supporting the rating process, such as changes in IT governance or systems.

Questions

- Q.14 Do you agree that the further changes outlined under paragraph 27 qualify as ‘material changes’? If not, please explain why.**
- Q.15 Are there additional ‘material changes’ that ESMA should include in the draft guidelines?**

4. Calculation of the supervisory fee and CRA market share

4.1 Supervisory Fees

Overview

40. Article 19 of CRA Regulation states that “*ESMA shall charge the credit rating agencies fees in accordance with this regulation and with the Commission regulation referred to in paragraph 2*”. On 7 February 2012 the European Parliament and the Council adopted the Commission Delegated Regulation (EU) No 272/2012 with regard to fees charged by ESMA to credit rating agencies (“Fees Regulation”).
41. The Fees Regulation details the basis and calculation method for the supervisory fees. Article 3(1) of the Fees Regulation provides that “*For the purposes of calculating the fees referred to in Article 5, Article 7(1) and Article 11(1) and (2), the applicable turnover for a given financial year (n) shall be the revenues of a credit rating agency as published in its audited accounts of the previous year (n-1) generated from rating activities and ancillary services*”.
42. Non-rating activities and/or non-ancillary services are therefore excluded in the calculation of the CRA’s applicable turnover. CRAs who claim to provide non-rating activities and/or non-ancillary services should provide ESMA with a detailed description of such activities and services and the amount billed for those services. ESMA will then assess, on a case-by-case basis, whether the revenues generated from those activities and services are eligible for deduction from the applicable turnover. In order to assure the accuracy and reliability of the amounts stated for non-rating and non-ancillary services, CRAs should also provide ESMA with certified data from their external auditors.
43. The measurement of the applicable turnover is therefore based on two types of revenues: (i) revenues generated from rating activities; and (ii) revenues generated from ancillary services.
44. With respect to the calculation of the revenues generated from ancillary services, the CRA Regulation does not provide a complete definition of ancillary services. The second paragraph of Point 4 of Section B of Annex I of the CRA Regulation states “*A credit rating agency may provide services other than the issue of credit ratings (ancillary services). Ancillary services are not part of credit rating activities; they comprise market forecast, estimates of economic trends, pricing analysis and other general data analysis as well as related distribution services*”. As a consequence, a case-by-case analysis is needed for assessing those services which are not to be considered as ancillary services. CRAs should provide ESMA with a detailed description of such services in order to allow ESMA to assess whether those activities are to be considered as non-ancillary services.
45. As the relevant provisions (Recital 6⁶ and 22⁷ of CRA Regulation, first part of last paragraph

⁶ Recital 6 of CRA Regulation: “*In addition to issuing credit ratings and performing credit rating activities, credit rating agencies should also be able to perform ancillary services on a professional basis. The performance of ancillary services should not compromise the independence or integrity of credit rating agencies’ credit rating activities*”.

⁷ Recital 22 of the CRA Regulation provides among other things: “*However, credit rating agencies should be able to provide ancillary services where this does not create potential conflict of interest with the issuing of credit ratings*”.

of Point 4⁸ of Section B of Annex I of the CRA regulation and Recital 4⁹ of Fees Regulation) focus on avoiding any potential or actual conflict of interests between rating activities and ancillary services, regardless of the entity to which services are provided, ancillary services are as a general principle permitted by the CRA Regulation as long as their provision does not create any potential conflict of interests with the issuance of credit ratings.

46. ESMA is of the view that the provision of ancillary services does not present any structural potential conflict of interests where the issuance of credit ratings is limited to the provision of rating activities and ancillary services to different clients, due to a deliberate and clear decision to provide them to a separate client base. Taking into account Recital 4 of Fees Regulation, revenues from the provision of such ancillary services, which do not create any potential conflicts of interest, may therefore be eligible for deduction from the applicable turnover.
47. To assess the absence of potential conflict of interests, ESMA needs an overview of the CRAs' structure when providing different types of services to different clients' bases. ESMA also must assure the accuracy and reliability of revenues generated by ancillary activities. To do this, ESMA needs to receive certified data from the CRAs' external auditors. This data should be on a client-by-client and on an aggregated basis for revenues generated by ancillary services which are provided to clients who do not receive rating services in the applicable financial year. Changes to the CRAs' structure or to the policy to provide ancillary services to a given client base should also be communicated to ESMA.
48. The calculation of a CRA's supervisory fees and the subsequent possible deduction of the revenues generated from certain ancillary services from the CRAs' applicable turnover are without prejudice to ESMA's on-going supervisory powers in accordance with the CRA Regulation.

Proposed Guidelines

49. For the calculation of supervisory fees, CRAs should submit to ESMA the annual audited accounts for the previous year at the latest by 31st May each year.
50. Where a CRA identifies revenues as generated from non-rating activities and/or non-ancillary services, the CRA should provide ESMA with a detailed description of such activities and services in order to allow ESMA to assess whether the revenues generated from these activities and services are eligible for deduction from the applicable turnover. The amounts corresponding to non-rating activities and/or non-ancillary services should be certified by the CRA's external auditors.
51. CRAs providing ancillary services should provide ESMA with a detailed description of such services in order to allow ESMA to assess whether those activities can be considered as non-ancillary services.
52. Where a CRA provides rating activities and ancillary services to different client bases and requests to deduct those amounts from the calculation of the revenues generated from

⁸ First part of the last paragraph of Point 4 of Section B of Annex I of the CRA regulation states: "A credit rating agency shall ensure that the provision of ancillary services does not present conflict of interest with its credit rating activities and ..."

⁹ Recital 4 of Fees Regulation, last sentence: "Moreover, the provision of ancillary services requires additional supervisory effort as possible conflict of interest resulting from the provision of ancillary services need monitoring".

ancillary services, the CRA should provide ESMA with a detailed description of its internal structure to allow ESMA to obtain an understanding of the CRA's structure and assess whether there is a deliberate and clear structural decision to provide those services to separate client bases. On this basis, ESMA will assess whether the revenues generated from those differentiated client bases are eligible for deduction from the applicable turnover. The amounts corresponding to the revenues generated from ancillary services which are provided to clients who do not receive rating services in the applicable financial year should be certified by the CRA's external auditors on a client-by-client and aggregated basis. Any change to the CRAs' structure or to the policy to provide ancillary services to a given client base should be communicated to ESMA.

53. For the purpose of the above-mentioned calculation and the assessment of the absence of potential conflicts of interests, a client who claims to receive only ancillary services is a client as defined by the last paragraph¹⁰ of point 2 of Part II of Section E of Annex I of CRA Regulation who does not receive any rating service from the CRA group.
54. Where a CRA requests any other adjustments to the applicable turnover, the CRA should provide ESMA with a detailed description of the requested adjustment and the reasons for such an adjustment. The amounts corresponding to such adjustments should be certified by the CRA's external auditors.
55. The calculation of a CRA's supervisory fees is without prejudice to ESMA's ongoing supervisory powers to assess whether the provision of ancillary services provided by a CRA constitutes a potential conflict of interest in practice and where it is the case, to take appropriate measures in accordance with the CRA Regulation.

Questions

Q.16 Do you agree that CRAs should identify and describe revenues generated from non-rating activities and/or non-ancillary services to help ensure that ESMA calculates supervisory fees on a fair and consistent basis? If not, please explain why.

Q.17 Do you agree that where rating activities and ancillary services are provided to different clients, due to a deliberate and clear decision to provide them to separate client bases, the provision of ancillary services does not present any structural potential conflict of interest with the issuance of credit ratings and consequently, those amounts are eligible for deduction from the applicable turnover? If not, please explain why.

Q.18 Do you agree that any amount to be deducted from the CRA's applicable turnover should be certified by the CRA's external auditors to help to ensure that ESMA calculates supervisory fees on a reliable and accurate basis? If not, please explain why.

¹⁰ Last paragraph of point 2 of Part II of Section E of Annex I of CRA Regulation states: "*client means an entity, its subsidiaries, and associated entities in which the entity has holdings of more than 20%, as well as any other entities in respect of which it has negotiated the structuring of a debt issue on behalf of a client and where a fee was paid, directly or indirectly, to the credit ratings agency for the rating of that debt issue*".

4.2 CRA market share calculation

56. Article 8d of the CRA Regulation requires ESMA to annually publish on its website a list of registered credit rating agencies, and include information on their total market share and the types of credit ratings issued. The calculation of CRA market share is made on the same basis as the calculation of supervisory fees¹¹. However, CRAs' financial years differ and this makes comparison difficult.
57. ESMA is of the view that CRAs should provide ESMA with the financial accounts for the full calendar year. To assure the accuracy and reliability of the amounts corresponding to the requested adjustment, CRAs should provide ESMA with certified data from their external auditors on the adjustments performed in their annual turnover when aligning financial years with calendar years.

Proposed Guidelines

58. For the purpose of calculating the yearly CRA market share, CRAs having a financial year different from the calendar year should provide ESMA with the financial accounts adjusted to the calendar year. The amounts corresponding to such adjustments should be certified by the CRA's external auditors.

Question

- Q.19. Do you agree that ESMA should calculate market share based on a CRA's calendar year accounts rather than its accounting period?**

¹¹ Article 8d(3) of CRA regulation refers to “*turnover generated from credit rating activities and ancillary services, at group level*”.



Annex 1: Cost benefit analysis

Impact Assessment

Introduction

1. This impact assessment assesses from a qualitative perspective, the costs and benefits that will potentially arise from the application of these draft guidelines. Stakeholders' views are sought on this assessment; quantitative data would be particularly useful in helping ESMA reach a final decision.

Objectives of the draft guidelines

2. The draft guidelines are aimed at promoting standardisation in the information periodically submitted by ESMA and to widen the scope of information provided by CRAs. These draft guidelines should contribute to the development of more effective and efficient supervision by ESMA through the standardisation of information submitted and by aligning the information submitted to ESMA more closely to what it considers the key risks in the sector.

What is the problem?	<ul style="list-style-type: none"> • ESMA does not receive on a consistent basis periodic information in relation to its ongoing supervision and the calculation of fees and CRA markets share . • There are certain areas of supervision which ESMA has identified as a high risk to the CRA sector in general, however the periodic information currently collected does not sufficiently include information on these areas.
What regulatory objective is put at risk by the problem?	<ul style="list-style-type: none"> • ESMA needs to ensure that the CRA regulation is applied. • In order to do this it needs to have a baseline of information provided on a timely and consistent basis from CRAs.

Policy Objectives

3. The main policy option to address the stated policy objective is to standardise and widen the information that CRAs are required to submit to ESMA. ESMA is of the view that the overall costs do not outweigh the benefits and the issuing of these guidelines supports efficient and effective supervision by ESMA and minimises the costs of regulation for regulated CRAs. However, an alternative option is to continue with the current periodic reporting requirements.

Policy Objective	Sufficient and timely information for ESMA to carry out its duties in relation to supervision in a risk based, fair and consistent manner and the calculation of fees and market share on a fair and consistent basis.
Option 1	Report according to consultation paper

Option2	Do not report according to consultation paper
Preferred Option	Option 1

Cost benefit analysis

Option 1	Qualitative description
Benefits	<ul style="list-style-type: none"> • Users of credit ratings and rated entities should benefit from more effective supervision of credit rating agencies. • Credit rating agencies should benefit from accurately calculated and fairly distributed supervisory fees. • ESMA is of the view that the application of these draft guidelines will improve the comprehensibility, relevance and comparability of information provided to ESMA. This will help ESMA develop a more detailed view of areas which ESMA has identified in its public reports as posing risks to its regulatory objectives and also help ESMA provide value for money in its supervision. • In the long term, the standardisation and widening of information submitted periodically by CRAs will enable ESMA to provide greater value for money in its supervision and further support risk based supervision to order to meet the regulatory objectives of ESMA.
Compliance costs	<ul style="list-style-type: none"> • CRAs may incur costs with the implementation of these draft guidelines such as the adaption of processes in collating periodic information and the additional cost of certification by auditors. However such costs should be mitigated on the basis that: <ul style="list-style-type: none"> ○ CRAs already provide information periodically; they do not need to design new processes, but would instead need to extend processes already established to include further information. ○ The further information for CRAs to submit should be information produced by the CRA in the running of its business. The CRA should not have to draft any documents specifically for ESMA. ○ In some instances where the guidelines extend the submission of periodic information, CRAs only need to submit information where ESMA should be updated on new information, for example, in key personnel changes. ○ In the calculation of supervisory fees, there will be increased assurance that supervisory fees have been accurately calculated and fairly distributed across CRAs. • CRAs may incur some costs in the on-going collation of documents to submit to ESMA. ESMA is of the view that costs will not be

	<p>significant. Ongoing costs will relate almost exclusively to updating information for every reporting period which will be limited given that reporting procedures are already in place.</p>
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Annex II: List of consultation questions

Q1. Do you agree that ESMA should be kept up to date with the changes to a CRA's Board and senior management as described above?

Q.2 Do you agree that the receipt of INED's opinions will provide ESMA with useful insight as part of its supervisory responsibilities? If not, please explain.

Q.3 Is there further information that the draft guidelines should include on Board minutes and INED opinions?

Q.4 Do you agree that it is helpful in ESMA's supervision of CRAs to receive information on the legal risks that CRAs are exposed to? If not, please explain.

Q5. Is there further information that ESMA should receive in regards to a CRA's legal risk?

Q6. Are there further possible instances that may result in a potential breach of the initial conditions of registration that should be included in the guidelines as examples?

Q.7 Do you agree that ESMA should receive CRA's internal audit workplans? If not, please explain.

Q.8 Do you agree that the submission to ESMA of follow up actions and disciplinary measures undertaken after internal reviews are a useful way for ESMA to monitor a CRA's risk management? If not, please explain.

Q.9 Is there further information that CRAs should submit on receipt of a complaint?

Q.10 Do you agree that the submission of CRAs' IT strategy and workplans would aid ESMA in the monitoring of CRA IT risk? If not, please explain.

Q.11 Do you agree that the regular and consistent submission of organisational charts to ESMA contributes to the better supervision of CRAs? If not, please explain.

Q.12. Do you agree with the proposal that ESMA should receive information on quarterly revenues per i) type of credit rating and ii) costs? If not, please explain.

Q.13 Do you agree with the proposed periodic reporting of changes in key positions and headcount? If not, please explain.

Q.14 Do you agree that the changes outlined above qualify as 'material changes'? If not, please explain why.

Q.15 Are there further 'material changes' that ESMA should include in the draft guidelines?

Q.16 Do you agree that CRAs should identify and describe revenues generated from non rating activities and/or non ancillary services to help ensure that ESMA calculates supervisory fees on a fair and consistent basis? If not, please explain why.

Q.17 Do you agree that where rating activities and ancillary services are provided to different



clients, due to a deliberate and clear decision to provide them to separate client bases, the provision of ancillary services does not present any structural potential conflict of interest with the issuance of credit ratings and consequently, those amounts are eligible for deduction from the applicable turnover? If not, please explain why.

Q.18 Do you agree that any amount to be deducted from the CRA's applicable turnover should be certified by the CRA's external auditors to help to ensure that ESMA calculates supervisory fees on a reliable and accurate basis? If not, please explain why.

Q19. Do you agree that ESMA should calculate market share based on CRA's calendar year accounts rather than its accounting period?

Annex III: Draft Guidelines

I. Scope

Who?

1. These Guidelines apply to credit rating agencies as defined in Article 3(1)(a) of the CRA Regulation.

When?

2. These Guidelines will be published in all EU official languages.

II. Definitions

3. CRA Regulation: Regulation (EC) No 1060/2009 of the European Parliament of the Council of 16 September 2009 on credit rating agencies amended by the Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011 and Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013.

III. Purpose

4. These guidelines set out the information that should be submitted by CRAs to enable ESMA to review submissions on a consistent basis as part of its ongoing supervision. These guidelines also clarify ESMA expectations on the information that should be submitted to ESMA in the calculation of supervisory fees and CRA market share.

IV. Compliance and reporting obligations

Status of the Guidelines and recommendations

5. This document contains guidelines issued under Article 16 of the ESMA Regulation. In accordance with Article 16(3) of the ESMA Regulation financial market participants must make every effort to comply with the guidelines and recommendations.

V. Information to be contained in the periodic submissions

6. The below sets out the information that CRAs should submit to ESMA quarterly, semi-annually and annually as part of their periodic submissions. Information should be submitted within one month after the end of the quarter.

Period	Submission deadline
1Q 20xx (up to 31 March 20xx)	30 April 20xx
2Q 20xx (up to 30 June 20xx)	31 July 20xx
3Q 20xx (up to 30 September 20xx)	31 October 20xx
4Q 20xx (up to 31 December 20xx)	31 January 20x(x+1)

7. Please note that, where fraudulent or irregular activity (e.g. employee or manager misconduct) has been identified, or breaches of the CRA Regulation that pose a risk to the integrity and objectivity of existing credit ratings, CRAs should immediately inform ESMA.

A. Quarterly information submissions

Financial revenues and costs (per type of credit rating and on individual and consolidated basis)

8. ESMA should receive information on quarterly revenues per i) type of credit rating and ii) costs. Quarterly revenues should be split across the following types of credit ratings: Corporate Non Financials; Corporate Financials; Sovereign/Public Finance; Structured Finance; Covered Bonds. Quarterly costs should show operational and total costs on a separate basis. Figures should be presented as quarter-on-quarter revenues and costs (rather than year-on-year).

Staff turnover, vacancies and key promotions

9. Quarterly changes in key positions include Lead Analysts and more senior staff (including senior IT management). Changes reported to ESMA should include both new appointments and resignations to help keep ESMA fully up to date with changes in key personnel.

FTE headcount

10. In addition to staff turnover data, ESMA should receive quarterly reports on total staff at CRAs expressed in terms of Full Time Employees.

Internal complaints submitted to the Compliance Department

11. CRAs should submit to ESMA:

- A description of the content of the complaint;
- The follow-up actions undertaken by the CRA;
- Information on whether an internal investigation was opened as a consequence, including the: status of the investigation (on-going / closed); where an investigation has been closed, a copy of the internal relevant report issued (if any).

B. Semi-annual information submissions

Board minutes, INEDs opinions and reports submitted to the Board

12. CRAs should submit on a semi-annual basis:

- The minutes of the board meetings;
- A copy of documents sent to board members in advance of board meeting as well as the documents discussed in the meeting (for instance, reports made by Compliance, Internal Audit Risk, internal review reports functions, IT strategy);
- CRAs should submit in the semi-annual submission any opinions presented by a CRA's INEDs pursuant to point 2 of Section A of Annex I of CRA Regulation and all reports (including follow-up reports) issued by an independent director.

Legal risks

13. Where the board minutes do not mention the status of litigation/ proceedings concerning the registered CRAs, ESMA should receive semi-annually a full list of pending legal proceedings.

Potential and actual cases of non-compliance with the CRA Regulation that have been identified and measures taken

14. CRAs should provide more detailed information regarding possible cases that may result in a breach of the initial conditions for registration, including:

- a. Descriptions of the possible cases that may result in a breach of the initial conditions for registration;
- b. Identification of the reasons that led to a case which could potentially result in a breach of the initial conditions for registration;
- c. Actions undertaken by the CRA following the identification of case that may potentially result in a breach of the initial conditions for registration;
- d. An indication of whether an internal investigation has been opened as a consequence, including: status of the investigation (on-going / closed) and where closed, a copy of the relevant report issued (if any).

15. Please note that, where alleged fraudulent or irregular activity (e.g. employee or manager misconduct) has been identified, or cases that may result in a potential breach of the initial conditions for registration that pose a risk to the integrity and objectivity of existing credit ratings, CRAs should inform ESMA immediately.

Organisational charts

16. CRAs should submit copies of up to date organisational charts. The organisational charts should provide sufficient detail to identify the structure of the following departments (as applicable):

- Compliance function;
- Internal Audit;
- Internal Review function;
- Business lines in charge of the ratings activities;
- Information Security function;
- IT department.

Compliance, Internal Audit, Risk Management

17. CRAs should submit their Compliance work plan. Where a CRA has established an Internal Audit function, ESMA should receive a copy of the Internal Audit updated work plan (where an updated version has been produced during the period).
18. CRAs should submit to ESMA copies of the reports issued by the compliance, internal audit, risk management (covering, for example, operational or information security risks) and review functions. CRAs should provide details of any follow-up action / disciplinary measures undertaken after these incidents or after the conclusion of a review and a copy of any closing report produced. This will aid ESMA in the monitoring of a CRA's own risk management.

IT strategy and governance

19. ESMA should be informed of CRAs' IT strategy and IT work plan, and of changes made to those, so as to be able to monitor more effectively IT risk.

Other areas

20. CRAs should also report:
 - New potential and actual conflicts of interest identified and measures taken;
 - Information on the initiation of any internal review being performed or intended to be performed on rating models and rating processes;
 - Outcomes of the methodology reviews including information on any back-testing performed in the period, details of any key findings as well as actions taken by the CRA as a result.

C. Annual information submissions

21. CRAs should annually report to ESMA:
 - List of fees charged to each client for individual credit ratings and any ancillary services;
 - Pricing policies for different rating classes, including the fee structures and the

pricing criteria in relation to credit ratings for different asset classes.

VI. Notifications of material changes to the initial conditions for registration

22. ESMA considers a “material change” to be a change which may affect the substantive information submitted in the registration application and, more generally, any change that may affect compliance with the requirements of the EU Regulation.

23. CRAs should notify ESMA of the following material changes (non-exhaustive list):

- a. Opening and closing of branches;
- b. Use of endorsement;
- c. Outsourcing arrangements;
- d. Changes in the legal form;
- e. To the business combinations (including reorganisation or restructuring of the CRA activities and spin-offs);
- f. Type of business activities (including the provision of new services and launch of new product in both the rating or non-rating business);
- g. Class and type of credit ratings;
- h. In the ownership structure: acquisition or disposal of holdings above 10%;
- i. In the members of the supervisory/administrative board;
- j. To the compliance function and review function;
- k. In the procedures used to issue and review credit ratings;
- l. Material changes to financial resources;
- m. To the rating methodologies, models or key rating assumptions;
- n. Major changes in the IT process and information processing systems supporting the rating process, such as changes in IT governance.

VII. CRA supervisory fee and market share calculations

Supervisory fee

24. For the calculation of supervisory fees, CRAs should submit to ESMA the annual audited accounts for the previous year at the latest by 31st May each year.
25. Where a CRA identifies revenues as generated from non-rating activities and/or non-ancillary services, the CRA should provide ESMA with a detailed description of such activities and services in order to allow ESMA to assess whether the revenues generated

from these activities and services are eligible for deduction from the applicable turnover. The amounts corresponding to non-rating activities and non-ancillary services should be certified by the CRA's external auditors.

26. CRAs providing ancillary services should provide ESMA with a detailed description of such services in order to allow ESMA to assess whether those activities can be considered as non-ancillary services.
27. Where a CRA provides rating activities and ancillary services to different client bases and requests to deduct those amounts from the calculation of the revenues generated from ancillary services, the CRA should provide ESMA with a detailed description of its internal structure to allow ESMA to obtain an understanding of the CRA's structure and assess whether there is a deliberate and clear structural decision to provide those services to separate client bases. On this basis, ESMA will assess whether the revenues generated from those differentiated client bases are eligible for deduction from the applicable turnover. The amounts corresponding to the revenues generated from ancillary services which are provided to clients who do not receive rating services in the applicable financial year should be certified by the CRA's external auditors on a client-by-client and aggregated basis. Any change to the CRAs' structure or to the policy to provide ancillary services to a given client base should be communicated to ESMA.
28. For the purpose of the above-mentioned calculation and the assessment of the absence of potential conflicts of interests, a client who claims to receive only ancillary services is a client as defined by the last paragraph¹² of point 2 of Part II of Section E of Annex I of CRA Regulation who does not receive any rating service from the CRA group.
29. Where a CRA requests any other adjustments to the applicable turnover (such as elimination of intercompany transactions), the CRA should provide ESMA with a detailed description of the requested adjustment and the reasons for such an adjustment. The amounts corresponding to such adjustments should be certified by the CRA's external auditors.
30. The calculation of a CRA's supervisory fees is without prejudice to ESMA's ongoing supervisory powers to assess whether the provision of ancillary services provided by a CRA constitutes a potential conflict of interest in practice and where it is the case, to take appropriate measures in accordance with the CRA Regulation.

CRA market share calculation

31. For the purpose of calculating the yearly CRA market share, CRAs having a financial year different from the calendar year should provide ESMA with the financial accounts adjusted to the calendar year. The amounts corresponding to such adjustments should be certified by the CRA's external auditors.

¹² Last paragraph of point 2 of Part II of Section E of Annex I of CRA Regulation states: "*client means an entity, its subsidiaries, and associated entities in which the entity has holdings of more than 20%, as well as any other entities in respect of which it has negotiated the structuring of a debt issue on behalf of a client and where a fee was paid, directly or indirectly, to the credit ratings agency for the rating of that debt issue*".

Annex 1 Summary of periodic information to be submitted to ESMA

New proposed information to be submitted is highlighted in bold.

A. Quarterly information submissions

- Financial revenues and costs (per type of credit rating and on individual and consolidated basis);
- Staff turnover, vacancies and key promotions;
- FTE headcount;
- **Internal complaints submitted to the Compliance Department.**

B. Semi-annual information submissions

- Information on the initiation of any internal review being performed or intended to be performed on rating models and rating processes;
- Outcomes of the methodology reviews including information on any back-testing performed in the period, details of any key findings as well as actions taken by the CRA as a result;
- Compliance, **Internal Audit, Risk Management and IT strategy and governance;**
- **Potential cases of non-compliance with the CRA Regulation that have been identified and measures taken;**
- New potential and actual conflicts of interest identified and measures taken;
- Board minutes, **INEDs opinions and reports submitted to the Board;**
- **Legal risks;**
- **Updated organisational charts.**

C. Annual information submissions

- List of fees charged to each client for individual credit ratings and any ancillary services;
- Pricing policies for different rating classes, including the fee structures and the pricing criteria in relation to credit ratings for different asset classes.