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PRESS RELEASE

ESMA finalises Guidelines on the validation and review of CRAs' methodologies

The European Securities and Markets Authority (ESMA) has published today its Final Report on Guidelines on the validation and review of Credit Rating Agencies' (CRAs) methodologies.

Steven Maijoor, ESMA Chair, said:

> "The Guidelines clarify how CRAs should validate and review their methodologies, furthering ESMA's work towards CRAs improving the quality of credit rating methodologies and credit ratings for the purpose of protecting investors and financial stability."

The Guidelines will increase the quality of the quantitative measures used by requiring CRAs to review their methodologies:

- *discriminatory power*, meaning their ability to rank the rated entities in accordance to their future status (defaulted or not defaulted) at a predefined time horizon.

- *predictive power*, by comparing the expected behaviour of the credit ratings to the observed results; and

- *historical robustness*, through the assessment of other elements of the methodology such as the stability of the credit ratings assigned by the methodology.

ESMA acknowledges there are challenges in validating methodologies with limited quantitative evidence and in such cases requires CRAs to consider data enhancement techniques as well as techniques enabling them to perform quantitative measures for demonstrating the discriminatory power of their methodologies. ESMA expects that even in cases where there is limited quantitative evidence, CRAs should demonstrate the robustness of their methodologies.

These Guidelines focus on quantitative measures as ESMA identified the industry requires more clarity in this area. However, ESMA believes that good a quality validation of methodologies strikes a balance between the application of quantitative and qualitative techniques. While stressing the importance of objectivity, which quantitative analysis brings to the process, validation should include both techniques.

ESMA considers implementing the Guidelines will raise the overall standard of validation by CRAs while allowing sufficient flexibility for the CRAs to choose the approaches that are the most relevant to their business, size and activity areas.

Next Steps

The Guidelines will be translated into the official languages of the European Union and become effective two months after their publication on ESMA's website.

Notes for editors

1. ESMA's mission is to enhance investor protection and promote stable and orderly financial markets.

   It achieves these objectives through four activities:

   i. assessing risks to investors, markets and financial stability;

   ii. completing a single rulebook for EU financial markets;

   iii. promoting supervisory convergence; and

   iv. directly supervising specific financial entities.

2. ESMA achieves its mission within the European System of Financial Supervision (ESFS) through active cooperation with the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Systemic Risk Board, and with national authorities with competencies in securities markets (NCAs).

3. Since 2011, ESMA has been the sole, direct supervisor of CRAs in the EU as was one of the EU's first regulatory responses to the financial crisis and is now responsible for overseeing the activities of 40 registered and 4 certified CRAs in the EU.

4. The CRA Regulation introduced a common approach to the Regulation and Supervision of CRAs within the European Union. This approach was designed to enhance the integrity, responsibility, good governance and independence of credit rating activities to ensure quality ratings and high levels of investor protection.

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

Further information:

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