



European Securities and
Markets Authority

Guidelines

**On the application of the endorsement regime under Article 4(3) of the
Credit Rating Agencies Regulation**



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I. Scope

Who?

1. These guidelines apply to credit rating agencies established in the Union and registered with ESMA (hereinafter “EU CRAs”) in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies¹ (hereinafter “CRAR”) which are endorsing or which intend to endorse credit ratings issued by a third-country CRA in accordance with Article 4(3) of the same Regulation.

What?

2. These guidelines concern particular matters relating to credit ratings issued in third countries and endorsed pursuant to Article 4(3) of CRAR. These guidelines add a new section (Section 5.3) to the “Guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation” published by ESMA on 17 November 2017 (ESMA33-9-205).

When?

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

¹ OJ L 302, 17.11.2009, p.1.

II. Legislative references, abbreviations and definitions

Legislative references

ESMA Regulation Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC²

CRAR The Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit ratings agencies³ as amended by Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011, Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011, Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013, and Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014

CRA 2 Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation (EC) No 1060/2009 on credit rating agencies⁴

CRA 3 Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies⁵

Abbreviations

CRA Credit rating agency

ESMA European Securities and Markets Authorities

Definitions

EU CRA A credit rating agency registered with ESMA.

Endorsing CRA An EU CRA which endorses or has endorsed one or more credit ratings in accordance with Article 4(3) of CRAR.

² OJ L 331, 15.12.2010, p. 84.

³ OJ L 302, 17.11.2009, p. 1–31.

⁴ OJ L 145, 31.5.2011, p. 30–56.

⁵ OJ L 146, 31.5.2013, p. 1–33.

Third-country CRA

A CRA which is registered and subject to supervision in a non-EU country.

Group of CRAs

As per Article 3(1)(m) of CRAR 'group of CRAs' means a group of undertakings established in the Union consisting of a parent undertaking and its subsidiaries within the meaning of Articles 1 and 2 of Directive 83/349/EEC as well as undertakings linked to each other by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC and whose occupation includes the issuing of credit ratings. For the purposes of Article 4(3)(a), a group of credit rating agencies shall also include credit rating agencies established in third countries.

The relevant endorsement provisions of CRAR

The provisions quoted in Article 4(3)(b) of CRAR: Articles 6 to 12 and Annex I of CRAR with the exception of Articles 6a, 6b, 8a, 8b, 8c, 8d and 11a, point (ba) of point 3 and points 3a and 3b of Section B as well as part III of Section D of Annex I of CRAR.

III. Purpose

4. CRAR entered into force on 7 December 2009. The amendments introduced by CRA 2 empowered ESMA to undertake the supervision of all CRAs in the European Union. The amendments introduced by CRA 3 created a set of new requirements for EU CRAs. These new requirements entered into force for the purposes of endorsement of credit ratings issued in third countries on 1 June 2018.
5. Article 21(3) of CRAR requires ESMA, in cooperation with EBA and EIOPA, to issue and update guidelines on the application of the endorsement regime under Article 4(3) of CRAR. In order to fulfil the requirements placed upon it by Article 21(3), ESMA is updating the Guidelines on Endorsement published on 18 May 2011.
6. With these guidelines, ESMA aims to bring clarity about the conditions for endorsement laid down in Article 4(3) of CRAR.

IV. Compliance and reporting obligations

IV.I Status of the guidelines

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

IV.II Reporting requirements

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

V. Guidelines

V.I Initial conditions for endorsement

9. An EUCRA should not begin endorsing credit ratings before ESMA has completed two separate assessments, namely: (1) an assessment of the conditions relating to the legal and supervisory framework of the third country as described in the Methodological Framework for Endorsement⁶; and (2) an assessment of certain conditions relating to the CRAs intending to endorse credit ratings.

V.II Ongoing obligations of an endorsing CRA

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

Requirements relating to Article 4(3)(b)

12. ESMA considers that compliance of the third-country CRA with the third-country legal and supervisory framework does not in and of itself prove that the third-country CRA is fulfilling requirements which are “as stringent as” the requirements set out in Articles 6 to 12 and Annex I of CRAR with the exception of Articles 6a, 6b, 8a, 8b, 8c, 8d and 11a, point (ba) of point 3 and points 3a and 3b of Section B as well as part III of Section D of Annex I of CRAR (hereinafter “the relevant endorsement provisions of CRAR”).
13. Instead, ESMA expects that the endorsing CRA has verified and is able to demonstrate that the third-country CRA has established internal requirements which are at least as stringent as the corresponding requirements in the relevant endorsement provisions of CRAR. ESMA, furthermore, expects that the endorsing CRA has verified and is able to demonstrate that the conduct of the third-country CRA fulfils the internal requirements set out by the third-country CRA on an ongoing basis.
14. Where the third-country CRA chooses to directly fulfil the requirements set out in the relevant endorsement provisions of CRAR, ESMA does not expect the endorsing CRA to demonstrate that the third-country CRA has established internal requirements which are as stringent as the relevant EU requirements. In this case, ESMA only expects that the endorsing CRA verifies and is able to demonstrate that the conduct of the third-country CRA fulfils the relevant EU requirements.

⁶ Annex II of the Final Report (ESMA33-9-246) published on 17 July 2018.

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

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

18. With regard to point (c) of Article 4(3) of CRAR, the endorsing CRA should make available to ESMA, on an ad-hoc or periodical basis, any information which ESMA may need in order to be able to assess and monitor the compliance of the third-country CRA with the requirements laid down in Article 4(3)(b).

19. If the endorsing CRA identifies any factors outside of its control which may create limitations to ESMA's ability to assess and monitor the compliance of the third-country CRA, for example resulting from third-country legislation, ESMA expects that the endorsing CRA informs ESMA without undue delay.
20. With regard to point (c)-(d) of Article 4(3) of CRAR, when requested, in order to supervise EU CRAs on an ongoing basis, ESMA expects that the endorsing CRA provides any relevant information relating to an endorsed credit rating or the conduct of the third-country CRA.

Requirements relating to Article 4(3)(e)

21. ESMA considers that the following should, inter alia, be considered objective reasons within the meaning of Article 4(3)(e):
 - a. when a rated entity or instrument is non-EU⁷;
 - b. when an endorsed credit rating relating to an EU entity or instrument is dependent on the rating of a subsidiary or parent company of the rated entity which is non-EU;
 - c. when only a small part of a CRA's outstanding ratings in a narrowly defined asset class are EU entities or instruments and when analytical staff specialised in this asset class is based outside the EU. However, a CRA should continually ensure that it has specialised analytical staff based in the EU in proportion to the relevance of the asset class in the EU; and
 - d. when an event occurs that temporarily impacts the allocation of analytical capacity of a group of CRAs, such as in the following cases:
 - i. A CRA has only recently opened an EU office and the staff that have the experience to rate some EU entities or asset classes are not yet based in the EU.
 - ii. A corporate action such as a takeover or merger, if the rating activity no longer reflects the new corporate structure.
 - iii. Absence of key analytical staff which could not reasonably have been foreseen or planned for.

⁷ For the purposes of these guidelines, the country of an entity or financial instrument follows Articles 4-6 as well as Field 10 of Table 1 of Part 2 of Annex I of the Commission delegated Regulation 2015/2 of 30 September 2014 with regard to regulatory technical standards for the presentation of the information that CRAs make available to ESMA, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.002.01.0024.01.ENG

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

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

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

24. ESMA considers that a requirement can be considered to be as stringent as a requirement set out in CRAR within the meaning of Article 4(3)(b) when it achieves the same objective and effects in practice. ESMA considers that an endorsing CRA which is unable to demonstrate to ESMA that the conduct of the credit rating activities by the third-country CRA resulting in the issuing of an endorsed credit rating fulfils requirements which are at least as stringent as those set out in the relevant endorsement provisions of CRAR infringes Article 4(3)(b) of CRAR, unless the reason for the infringement is outside the CRA's knowledge or control. However, this should not be understood as relieving an endorsing CRA from its overriding obligation to verify the compliance of the conduct of the third-country CRA as specified in Paragraphs 15-17 above.
25. The following is a non-exhaustive list of alternative internal requirements which ESMA considers to be at least as stringent as a requirement set out in one of the relevant endorsement provisions of CRAR. However, where no alternative internal requirement is provided in these guidelines, ESMA recommends that the endorsing CRA ensures that the third-country CRA directly fulfils the requirements set out in the relevant endorsement provisions of CRAR as per paragraph 14 above.
26. ESMA considers that an endorsing CRA has demonstrated to ESMA that the conduct of the credit rating activities by the third-country CRA resulting in the issuing of an endorsed credit rating fulfils requirements which are at least as stringent as those set out in:
- a. Article 7(4) and Point 8 of Section C of Annex I of CRAR (**Rotation**), where the third-country CRA does not subject its staff to rotation of the length and frequency required under these provisions, but instead:
 - i. records the length of time an analysts, a lead analyst and a person approving credit ratings is assigned to a single issuer;
 - ii. ensures that analysts, lead analysts and persons approving credit ratings are subject to an appropriate rotation mechanism which provides for a gradual change in analytical teams and credit rating committees; and
 - iii. has in place dedicated and robust internal requirements relating to potential conflicts of interest between an analyst and a rated entity;
 - b. Article 7(4) and Point 8 of Section C of Annex I of CRAR in conjunction with Article 6(3) of CRAR, where the third-country CRA does not subject its staff to any rotation and the endorsing CRA has verified and is able to demonstrate to

ESMA that the third-country CRA meets the conditions for the exemption set out in Article 6(3) of CRAR;

- c. Article 8(7)(a) of CRAR (**Errors in methodologies**), where the endorsing CRA reports the information set out in these provisions to ESMA for a credit rating it has endorsed, in the same manner it reports such information for credit ratings issued in the EU;
- d. Article 10(2a) of CRAR (**Inside information**), where the credit ratings to be endorsed, rating outlooks and information related thereto are treated according to that third-country regime's requirements for the handling of inside information up until the point of publication/disclosure and where the third-country CRA adheres to the requirements regarding protection of confidential information set out in Article 7(3) as well as Paragraph 3 of Section C of Annex I of CRAR;
- e. Article 10(3) and (5) of CRAR (**Rating disclosures**), where the relevant disclosures are made in accordance with the definitions set out in CRAR clearly and prominently but without the use of a distinguishing symbol or a colour code;
- f. Article 11(3) and point 2 of Part II of Section E of Annex I of CRAR as further specified in the Delegated Regulation on Fees⁸ (**Reporting of information about fees**), where records are kept of the third-country CRA's pricing policies, procedures and fee schedules and deviations from these are recorded. ESMA will request these records and related information from CRAs on an ad hoc basis;
- g. Article 12 and Part III of Section E of Annex I of CRAR (**Transparency Report**), where the endorsing CRA includes information about the endorsed credit ratings in its own transparency report, ensuring that:
 - i. the description of the internal control mechanisms ensuring quality of a CRA's credit rating activities includes control mechanisms applicable to endorsed credit ratings;
 - ii. the outcome of the annual internal review of a CRA's independent compliance function takes into account the role of the endorsing CRA's compliance function with respect to endorsed ratings;
 - iii. the description of the policy for record-keeping and analyst rotation indicates whether such policies are global or only applied to EU ratings; and

⁸ The European Commission Delegated Regulation (2015/1) of 30 September 2014 supplementing CRAR with regard to regulatory technical standards for the periodic reporting on fees charged by credit rating agencies for the purpose of ongoing supervision by the European Securities and Markets Authority.

- iv. the financial information on the revenue of the endorsing CRA, including total turnover and the geographical allocation of that turnover to revenues generated in the Union and revenues worldwide clearly states whether revenues from endorsed ratings are taken into account;
- h. Paragraph 3(aa) of Section B of Annex I (**Cross-shareholdings**), where the endorsing CRA only endorses a new credit rating which is potentially affected by the situation set out in this provision when:
 - i. this is clearly and prominently disclosed;
 - ii. the third-country CRA has verified that the shareholder or member of the CRA is not in a position to exercise significant influence on the business activities of the CRA⁹;
 - iii. the third-country CRA has robust internal requirements to ensure that the shareholder or member is not able to exercise any influence on the credit rating; and
 - iv. the holding of capital or voting rights in the third-country CRA is no more than 20%;
- i. Point 3c of Section B of Annex I of CRAR (**Requirements relating to fees**), where the fees charged for credit ratings and ancillary services do not depend on the level of credit rating issued or on any other result or outcome of the work performed and where the fees charged for credit ratings and ancillary services are established in compliance with the relevant competition and antitrust rules in place in the third country;
- j. Point 3 of Part I of Section D of Annex I of CRAR (**Pre-publication notification**), where the third-country CRA:
 - i. notifies a rated entity about a rating action in advance of publication;
 - ii. during the business hours of the rated entity; and
 - iii. provides the rated entity with a reasonable amount of time to provide feedback taking into account, inter alia, the CRA's other regulatory obligations;
- k. Point 6 of Part I of Section D of Annex I of CRAR (**Initial assessments and preliminary ratings**), where the third-country CRA does not knowingly incentivise or facilitate rating shopping.

⁹ As set out in International Accounting Standard no. 28: Investments in Associates and Joint Ventures, paragraphs 5-6.