



COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Date: 6 December 2010

Ref.: CESR/10-1424

REPORT

**CESR Annual report
according to article 21 of
Regulation (EC) 1060/2009 on
Credit Rating Agencies**



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Executive Summary

On 12 November 2008 the European Commission published a draft Regulation (EC) 1060/2009 on credit rating agencies (CRAs), whose amended version was approved on 23 April 2009 by the European Parliament and on 27 July 2009 by the Council. The Regulation was signed on September 16 and entered into force on 7 December 2009.

Consequently, CRAs that wish to operate in the Community must apply for registration under the terms of the Regulation and comply, at all times, with the organizational, operational, procedural and disclosure requirements set out in its Annex I.

CESR is publishing this annual report in accordance with article 21(4) of Regulation (EC) 1060/2009, in order to provide information to the public about the application of the Regulation in the EU and, in particular, to comment on the implementation of the requirements established in Annex I of the Regulation by the credit rating agencies. This is the first annual report published by CESR in the fulfilment of its obligations under article 21.

At the time of the publication of this report only one credit rating agency has been registered, while assessment of the other 23 applications received by CESR between the 7th of June and the 7th of September 2010 is proceeding within the colleges of supervisors or the individual home competent authorities.

In light of the still ongoing work concerning most registration processes, the report focuses mainly on the major issues faced by competent authorities in their assessments of the applications received. In particular, this provides details relating to issues that refer to:

- the applications received from individual CRAs
- the applications received from groups of CRAs
- the assessment of third countries legal frameworks regarding CRAs

The first assessments of the applications that have been performed during the autumn of this year have served as preliminary tests for the functioning of the colleges of competent authorities. In this respect the main difficulties that have emerged are linked to the problem of ensuring consistency across colleges.

As opposed to the case of colleges, the assessments carried out by individual competent authorities on the applications submitted by local CRAs have proceeded at a faster pace in the course of 2010. However, competent authorities may have to face difficult decisions in ensuring that the application of the proportionality principle to local CRAs does not prejudice fulfilment of the overarching principles of the Regulation.

As the registration process is still pending for the large majority of the applications submitted by credit rating agencies, this report can only provide a high level description of the status of the application of Regulation (EC) 1060/2009. CESR is in fact not in the position to report in detail about the implementation of the requirements set out in Annex I of the Regulation, as the final shape of the policies, procedures and arrangements adopted for those purposes by the credit rating agencies will depend on the outcome of the interaction with the competent authorities as part the supervisory assessments concerning the applications for registration or certification.



I. Introduction

1. On 12 November 2008 the European Commission published a draft Regulation on credit rating agencies (CRAs), whose amended version was approved on 23 April 2009 by the European Parliament and on 27 July 2009 by the Council. The EU Regulation (EC) 1060/2009 was signed on September 16 and entered into force on 7 December 2009.
2. Consequently, credit rating agencies established in the Community that wish to provide ratings publicly disclosed, or distributed by subscription, shall apply for registration under Regulation (EC) 1060/2009 (hereinafter also “the Regulation”).
3. The Regulation requires registration of the issuing agency as a precondition for the use of credit ratings for regulatory purposes in the EU. However, the Regulation also foresees two mechanisms: endorsement and certification, which, alternatively to registration and establishment in the Community, allow agencies based in third countries to issue ratings suitable for regulatory use in the EU. Both these regimes hinges, although to a different extent, on the existence of requirements equivalent to - or as stringent as - those applicable in the EU in the jurisdiction of the third-country agency, demanding registration or authorisation of CRAs, as well as ongoing supervision, by a public authority.
4. The Regulation lays down rules that aim at ensuring that credit ratings used and disseminated through the Community are independent, objective and of adequate quality, and issued by credit ratings agencies in compliance with stringent organizational, operational, procedural and disclosure requirements. While the articles in the body of text define the general obligations imposed on credit rating agencies, the aforementioned more substantive rules and requirements are mainly set out in Annex I of the Regulation.

CRAs that wish to operate in the Community must apply for registration under the terms of the Regulation and comply, at all times, with the requirements set out in its Annex I.

5. CESR is publishing this annual report according to article 21(4) of Regulation (EC) 1060/2009, in order to provide information to the public about the overall status of the implementation of the Regulation in the EU and, in particular, to refer on the implementation of the requirements established in Annex I of the Regulation by the credit rating agencies. This is the first annual report published by CESR in fulfilment of its obligations under article 21.

A. CESR activities during the course of 2010

6. According to the Regulation, CESR is required to discharge important co-ordination and advisory functions alongside its traditional role of promoting convergence through guidelines and recommendations. Recital 65 of the Regulation, in fact, explains how “*CESR should ensure coherence in the application of the Regulation. It should enhance and facilitate the cooperation and coordination of competent authorities in supervisory activities and guidance where appropriate*”. For this purpose, a Standing Committee (SC) has been set up in January 2010 to assist CESR in its new tasks relating to credit rating agencies.
7. Article 21 of the Regulation has required CESR to issue guidance on a number of supervisory subjects in the course of 2010. In order to fulfil these obligations, the Standing Committee on Credit Rating Agencies has set up four internal subgroups which have been appointed of the analyses relating to the different tasks assigned by article 21. In addition, a Consultative Working Group (CWG), composed of senior practitioners from the concerned industries has been established to support CESR in its work program. CESR has also consulted with CEBS and CEIOPS prior to issuing its guidance.
8. In 2010 CESR has published:
 - a) *Guidance on 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* (CESR/10-347);
 - b) *Guidelines for the implementation of the Central Repository* (CESR/10-331);



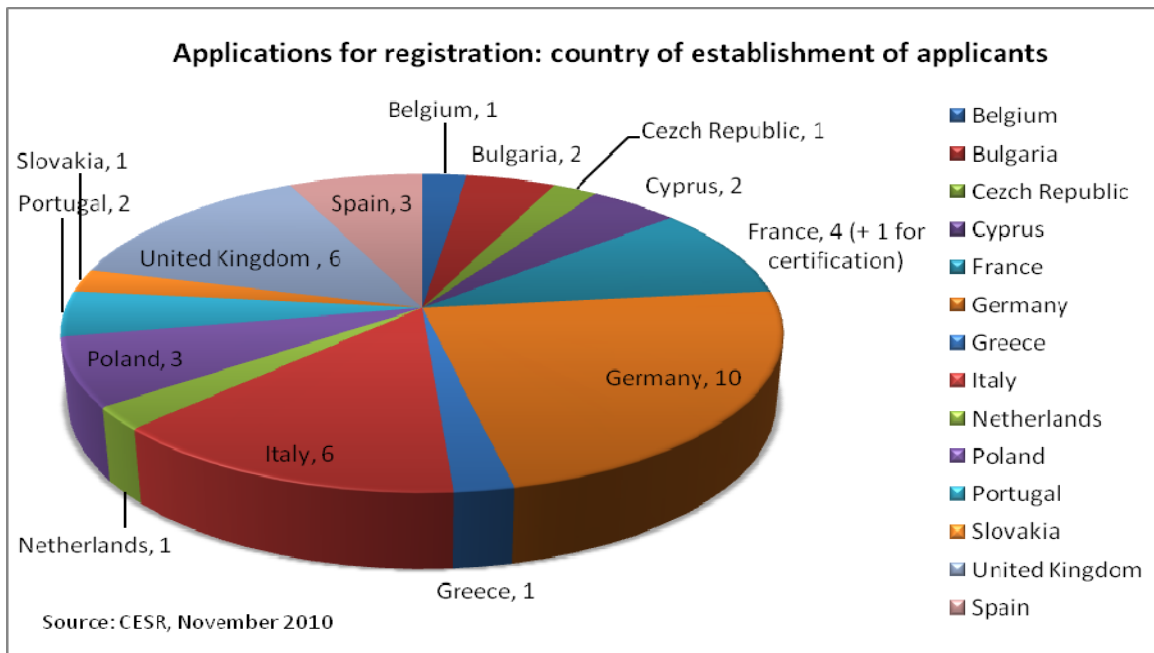
- c) *Guidance on enforcement practices and activities to be conducted by competent authorities under the Regulation (CESR/10-944);*
 - d) *Guidance on common standards for assessment of compliance of credit rating methodologies with the requirements set out in Article 8(3) (CESR/10-945).*
9. In order to elaborate its Guidance on Registration Process, CESR sought comments from the Consultative Working Group (on pre-consultation documents) in September 2009. Based on the feedback received, CESR produced a Consultation Paper, which was published on the 21st of October 2009 (CESR/09-955). Subsequently, as to facilitate the consultation process, CESR held an open hearing on 23 November 2009. The Guidance was published on 4 June 2010.
 10. CESR's Guidelines for the implementation of the Central Repository was published after consultation with CEBS, CEIOPS and the Consultative Working Group in April 2010.
 11. CESR put forward for consultation its draft Guidance on enforcement practices and activities during May and June 2010. Non-confidential responses to this consultation were published on the CESR website. Having considered the feedback received, CESR published its final guidance on 30 August 2010.
 12. Furthermore, CESR has published its "Frequently Asked Questions regarding the EU Regulation on Credit Rating Agencies: Common positions agreed by CESR Members"(CESR/10-122), in order to provide clarity to market participants with responses in a quick and efficient manner to questions which are commonly posed to CESR Members. These responses were provided following CESR's intention to operate in a way that enable its Members to react quickly and efficiently if any aspects of the supervisory process needs to be clarified to stakeholders. CESR is committed to reviewing and updating this document regularly.
 13. In the course of 2010 CESR has also intensively engaged in the assessment of the legal and supervisory frameworks of third countries and in negotiations concerning the establishment of cooperation arrangements with third country regulators, in order to serve the purposes of the endorsement and certification regimes established by the Regulation. CESR delivered its technical advice to the European Commission on the equivalence of the legal and supervisory frameworks concerning credit rating agencies in Japan (CESR/10-333) and the U.S.A. (CESR/10-332). The advice has been provided in response to a mandate that covers also Australia and Canada.
 14. Commencing from 7 June 2010, CRAs have submitted their applications for registration to CESR, pursuant to article 15(1) of the Regulation. CESR has consequently provided, according to article 15.4, its advice to the home competent authorities on the incompleteness of all these applications received. In addition, as of the date of this report, CESR has also provided its advice concerning compliance with the requirements for registration set out by the Regulation, in accordance with article 16(6), regarding one application submitted by a local individual CRA.
 15. According to the Regulation, CESR should ensure coherence in the application of the rules through the Community and "*enhance and facilitate the cooperation and coordination of competent authorities in supervisory activities CESR should therefore establish a mediation mechanism and peer review in order to facilitate a coherent approach by the competent authorities*" (recital 65). With respect to these tasks, the Guidance on Registration clarified how CESR should "*ensure that some form of record of the supervisory decisions of all the colleges is maintained and facilitate the centralization and sharing of the information contained therein, particularly during the registration period when interpretative decisions are being formulated*". Fulfilment of this obligation requires CESR to closely follow, support and monitor the assessments carried out by competent authorities or colleges of supervisors in the registration process.

B. Outlook of the current status of the registration process

16. The Regulation allowed CRAs to submit applications for registration starting from 7 June 2010. In addition, existing CRAs which were operating in the Community before 7 June 2010 have

been allowed to keep running their rating business even before being granted registration, and until this is explicitly denied, provided that these would apply by the 7th of September 2010.

17. As a consequence, between 7 June and 7 September 2010 CESR has received 23 applications for registration under the terms of the Regulation and 1 application for certification (from a Japanese agency). While most of these applications pertain to individual CRAs, 4 of the files received from CESR refer to groups of credit rating agencies, as defined in article 3(1.m) of the Regulation, and, therefore, covers several legal entities consisting in the various subsidiaries that are comprised in each group. Consequently, a total of 45 legal entities have applied for registration in the EU.
18. As the actual burden linked to compliance with the Regulation became clearer to applicants during the course of the first interaction with supervisors within the preliminary review of the information transmitted (assessment of completeness), the number of applications was reduced by a withdrawal that occurred in the elapsing of some months after the deadline of September 7. The details of the geographical distribution of the applicants are provided in the chart illustrated below; the data illustrated in this report refer to the applications processed or pending as of the 30th of November 2010.



19. As previously mentioned, CESR has concluded, after a first formal and immediate review of the material provided by the CRAs, that all applications received were partly or totally missing relevant information with respect to the requirements in Annex II of the Regulation and CESR Guidance on Registration. As a consequence, CESR has provided its advice on the incompleteness of the applications received to all the concerned home competent authorities of the applicants.
20. The assessment of completeness has involved, in many cases, more than one request of clarifications, integrations or reorganizations of the documentation submitted per applicant, as CRAs have seldom shown familiarity with the regulatory perspectives from which the information were to be presented to supervisors in order to let them discharge their obligations linked to the registration process.
21. Competent authorities will start dealing with the assessment of compliance of CRAs with the conditions for registration only after their respective applications can be formally deemed as



complete, hence, only after the CRA receives the notification of this in accordance with article 15(5) of the Regulation.

22. However, as review of the applications from the largest groups of credit rating agencies entails deep analysis of a wide array of complex and intertwined elements, including issues relating to endorsement of ratings from third jurisdictions. Therefore, competent authorities may have to ask the applicants about additional information on policies or procedures also at a later stage, as part of the assessment of compliance.
23. In light of the assessment timeframe and procedure established in articles 15, 16 and 17 of the Regulation, and having considered the current status of most registration processes and the quality and complexity of the applications received, it can be reasonably inferred that, in general terms, the outcome of the assessment of the applications for registration in the EU submitted by the largest groups of CRAs should be known during the second quarter of 2011.
24. Only Euler Hermes Rating GmbH, an individual local CRA established in Germany which has sent in the application already at the very beginning of the registration period, has been registered at the time of the publication of this report.

II. Applications received from individual CRAs

A. Background

25. A number of applications (17) have been submitted to CESR from individual CRAs performing business mainly focused on the issuance of ratings concerning local corporate entities. In particular, 8 of these applications came from local German CRAs¹, while the others refer to rating agencies established in: Portugal (1), Italy (2), Poland (1), Slovakia (1), Bulgaria (2), Greece (1) and Cyprus (1). As clarified in the following of this report, two other CRAs established in the UK have applied on an individual basis for registration in the EU, however, these seem to have characteristics which do not allow them to be considered as local agencies.

B. Main issues

26. Many local individual CRAs have a small size. These CRAs appeared in some circumstances as not having appropriate compliance structures in place before they decided to apply for registration under the Regulation. Policies, procedures and compliance systems needed, therefore, to be created from scratch and, in a number of cases, under constraints due to difficulties encountered when interpreting the requirements set out by the Regulation.
27. In particular, frequent problems have regarded the structuring of compliance policies and procedures. Some CRAs have developed and submitted policies which reiterated the requirements of the Regulation but did not provide for concrete measures in order to make sure that these requirements are actually complied with in practice.
28. Individual CRAs, in fact, seemed inherently keen to make large use of outsourcing, also of core functions, and leaning towards concentration of roles and responsibilities, with limited attention for the recommendations, or proper binding prohibitions, envisaged in the Regulation. Frequently, the senior management has appeared involved in the negotiation of fees as well as in the rating committees, regardless of the rules on separation of these activities provided for in the Regulation.
29. In some other cases, these CRAs seemed to initially experience problems in implementing structures and procedures to identify, prevent or mitigate conflicts of interests: in particular because of the relatively small size. In addition, some have adopted models that envisage the performance of rating activities in strict combination with non-rating activities. These business

¹ One of these applications has been subsequently withdrawn in early November 2010.

models seem to rely substantially, in order to result operationally viable and financially sound, on the facilities, systems and revenues generated by other non-ratings services of different types (consultancy, risk management services etc..). In such circumstances, the issuance of ratings appears to be, in spite of the reservation regime established by the Regulation, as only instrumental for the provision of other more profitable services, carried out directly by the applicants or, more often, by their associated companies.

30. It can be anticipated that in few circumstances the characteristics of the rating activities carried out by some individual CRAs have raised questions about whether or not the concerned ratings were actually public according to the definition in article 2(2.b) of the Regulation.

C. Open questions regarding local CRAs: the language barrier

31. The experience to date in 2010 with respect to the registration of local CRAs has raised important issues relating to the cost effectiveness, efficacy and potential for consistency of the supervisory framework established by the Regulation regarding these entities. Notably, a key issue has arisen regarding the language of the applications and, in general, of the interaction with supervisors.
32. Article 15(3) of the Regulation, in fact, requires credit rating agencies to submit their applications in the language which is required under the law of its home Member State and also in a language customary in the sphere of international finance. This language regime was probably meant to serve the pan-European scope of the registration for the sake of efficiency and competition in the internal market, as a CRA registered by a competent authority in a specific jurisdiction shall be anyways able to issue and distribute its ratings, at any time, throughout the all Community.
33. However, CESR Guidance on Registration concluded that compliance with the Regulation entails the set up of a working framework in a language that is common for all stakeholders in the registration process. Therefore, in case of local CRAs, where only the competent authority of the home Member State is involved in the supervision of the applicants, it could be possible that the exchange of relevant information takes place in the local language.
34. The table below illustrates the language used in the applications received from local CRAs.

Application	Language of application letters/notes	Language of support documents
1	English and Bulgarian	Bulgarian
2	English	partly Bulgarian and partly English
3	English	English
4	German	German
5	English and German	German
6	English	partly English and partly German
7	English and German	German
8	English and German	German
9	German	German
10	German	German
11	German	German
12	English and Greek	all documents in Greek and in English
13	Italian	Italian
14	Italian	partly Italian and partly English
15	Polish	Polish
16	Portuguese	Portuguese
17	English	English

35. The evidence to date in 2010 has highlighted that, in circumstances where applications have been submitted in local languages, CESR's ability to discharge its obligations under the Regulation, as set out in paragraph 15, was partly hampered: in these cases CESR was in fact compelled to rely upon assistance from national competent authorities.

III. Applications received from groups of CRAs

A. Background

36. According to article 15(2) of the Regulation, and as explained by CESR's Guidance on Registration (Part II, Section 2), CRAs that form part of a group of credit rating agencies can apply for registration in the EU by mandating one of them to submit a single request and documentation on behalf of all the concerned subsidiaries.
37. Four groups of credit rating agencies have applied for registration in the EU under the terms of the Regulation². Collectively, the legal entities and other offices (branches) comprised in these groups cover, in terms of place of establishment, the following countries: France, United Kingdom, Germany, Spain, Italy, Czech Republic, Cyprus, Sweden, Poland, Portugal, the Netherlands and Belgium.
38. Three of these groups cover, individually and to a greater extent altogether, a very remarkable share of the European and global ratings markets. The assessment of the eligibility for registration of these groups requires dealing with complexities that are not inherent in assessing individual CRAs. These elements of complexity stem, for example, from the size, structure and governance of the CRAs in the groups, as well as for the diversity of their rating operations and, last but not least, their intention to endorse ratings issued from affiliated agencies established in several countries outside of the Community.

B. The ongoing work to ensure consistency among Colleges of Supervisors

39. It is with respect to the registration of groups of CRAs that the Regulation envisages most benefits from the functioning of colleges of competent authorities. In fact, while the establishment of a college of supervisors is optional in case of applications from a single agencies, as regulators other than the home competent authority have the option but not the obligation to candidate themselves³ for the college, this becomes mandatory for applications from groups of CRAs. In the latter case, the home competent authorities of all credit rating agencies comprised in the group shall necessarily constitute a college of supervisors (article 29(2)).
40. Colleges of supervisors constitute the main mechanism established by the Regulation in response to the need to pursue a coordinated European-wide approach to the supervision of CRAs, as these entities engage in the production of services (the ratings) which are very often elaborated or distributed on a cross border basis.

² This number is drawn taking into account the definition of group of credit rating agencies set forth in article 3.1(m) of the Regulation. According to that provision only CRAs established in the Community should be construed as forming a group. However, two additional applications could be considered - de facto - as referring to groups of CRAs: these regard two UK based individual CRAs that are part of group structures with parent and affiliated rating agencies established outside of the EU.

³ As clarified in article 29(3) of the Regulation, a competent authority may join at any time a college of supervisors provided that the concerned CRA: i) has branched (or other undertakings within its group structure) established within the jurisdiction of that competent authority, or, ii) the use for regulatory purposes of ratings issued by the applicant CRA (or group of CRAs) is widespread or has or is likely to have a significant impact within the jurisdiction of the mentioned competent authority.



41. Article 29(5) of the Regulation states that “*within 15 working days of the establishment of the college, its members shall select a facilitator, consulting CESR in the absence of agreement*”. The facilitator shall “*chair the meetings of the college, coordinate the actions of the college and ensure efficient exchange of information among members of the college*” (article 29(6)).
42. Following receipt of the applications, competent authorities have formed 6 colleges of supervisors, four (mandatory) colleges concerning the applications received by the 4 groups of CRAs and 2 additional colleges⁴ relating to individual CRAs whose ratings were deemed as having cross-border relevance.
43. In advance of going through the number of documents received from the major international groups of CRAs, the facilitators have promptly taken action in order to organize the work of the colleges. Facilitators have in fact strived in order to: i) ensure mutual consistency across colleges, ii) enhance the efficiency of the assessment process and, iii) secure a coherent approach to the analysis of the key issues which characterize the different applications.

C. Main issues

44. The rating activities performed by groups of CRAs, because of their systemic importance throughout the Community, present several aspects that deserve particular analysis. An immediate issue regards, in light of the size and wide array of activities performed by these entities, the subject of the policies and procedures adopted for the identification, prevention and management of the conflicts of interests which may affect the issuance of ratings.
45. Discussion at the Standing Committee has focused for a long time on the level of flexibility which could be adopted by competent authorities in granting exemptions from compliance with certain requirements of the Regulation, as contemplated in article 6(3). These requirements, in fact, relate to some of the fundamental safeguards (rotation of analysts, independent directors and compliance functions) that are introduced by the Regulation against the possible emergence of conflicts of interests at different key levels of the rating process.
46. It is anticipated that an area which will be a common to large group applications in terms of how they comply with the requirements of the Regulation relates to the models adopted for the organization and functioning of both the business lines and the internal controls across the legal entities within the large groups of CRAs. In particular, the information submitted to date has shown how groups have often kept a preference for maintaining a horizontal organization of both the operational bodies (such as in first place the rating committees) and the control functions (risk assessment, internal control and, foremost, compliance), which often act transversally according to global policies and procedures on account of a number of CRAs established in different jurisdictions.

IV. Assessment of third countries’ legal frameworks regarding CRAs

A. Background

47. As mentioned in CESR Guidance on Registration, the endorsement of ratings from third-country CRAs which meet on a voluntary basis requirements that are “as stringent as” those of the Regulation is only possible during the transition period ending on 7 June 2011. After that deadline, EU supervisors shall assess the legal and supervisory framework that needs to be in place in the third country jurisdiction in order to allow the endorsement of ratings from those jurisdictions.
48. These assessments may overlap with the analyses of third country regimes which CESR is compelled to perform in order to support possible determinations of equivalence made by the European Commission for the purposes of certification. As a consequence, CESR has developed a specific methodology.

⁴ In effect, another additional college, comprised of a single competent authority, has been formally set up to carry out the assessments of the application for certification submitted by a Japanese CRA.



49. The groups of CRAs that are interested in making use of endorsement are looking, collectively, to import ratings from 26 jurisdictions. CESR has to date been mandated to provide advice to the European Commission in respect of the equivalence with the EU regime of 4 jurisdictions (US, Canada, Australia and Japan).
50. CESR is currently in the process of determining which of the 26 countries that have been indicated as relevant for endorsement during the transition phase, will likely remain candidate jurisdictions for endorsement post June 2011.

B. Concerns relating to the applications for the endorsement of ratings

51. Several elements have emerged from the applications submitted by groups of CRAs as regards the endorsement of ratings. In particular, each group has applied to endorse ratings from between 12 and 19 agencies established in different countries. Furthermore, the endorsing agencies of each group, which consist mainly in subsidiaries established in the UK⁵, intend to import into the EU nearly all types of credit ratings (corporate, structured finance and public ratings).
52. A crucial point regards the objective reasons underlying the intention to endorse ratings from third countries. In this respect supervisors would expect to receive, in accordance with article 4(3.c) of the Regulation, detailed explanations and information highlighting, if appropriate, the relevant geographical, business or sector drivers for the issuance of these ratings outside of the Community.
53. It can be anticipated that some issues have emerged as regards the procedures adopted by the endorsing CRAs to monitor that the third country agencies de facto fulfil the requirements of the Regulation, on which the information provided has often appeared to be generic.

V. Conclusions

54. This is the first annual report published by CESR pursuant to article 21 of the Regulation. As the registration process is still pending for the large majority of the applications submitted by CRAs during the summer of 2010, this report can only provide a high level description of the status of the application of Regulation (EC) 1060/2009.
55. CESR is in fact not in the position to comment in detail about the implementation of the requirements set out in Annex I of the Regulation, as the final shape of the policies, procedures and arrangements adopted thereof by the applicants will depend on the outcome of the interaction with the competent authorities during the assessment process. While CESR has received applications for registration (or certification) in the EU from 45 legal entities in total, at the time of the publication of this report only one individual CRA has been registered.
56. The first assessments of the applications that have been performed during the autumn of this year have served as preliminary tests for the functioning of the colleges of competent authorities. As expected, the operation of these frameworks has revealed some difficulties mainly linked to the problem of ensuring consistency, in terms of analyses and conclusions, across colleges. Nonetheless, college members and facilitators have strived and taken initiatives in order to reinforce mutual understanding and improve coordination.
57. In comparison to the case of colleges, the assessments carried out by individual competent authorities on the applications submitted by local CRAs have proceeded at a faster pace. However, supervisors may have to face difficult decisions in ensuring that the application of the proportionality principle to individual local CRAs is realized under full respect for the overarching principles of the Regulation.

⁵ Only one group intends to endorse ratings, in addition to the London office, also from a subsidiary based in Germany.