



European Securities and
Markets Authority

Final report

ESMA's Technical Advice to the Commission on Fees for CRAs

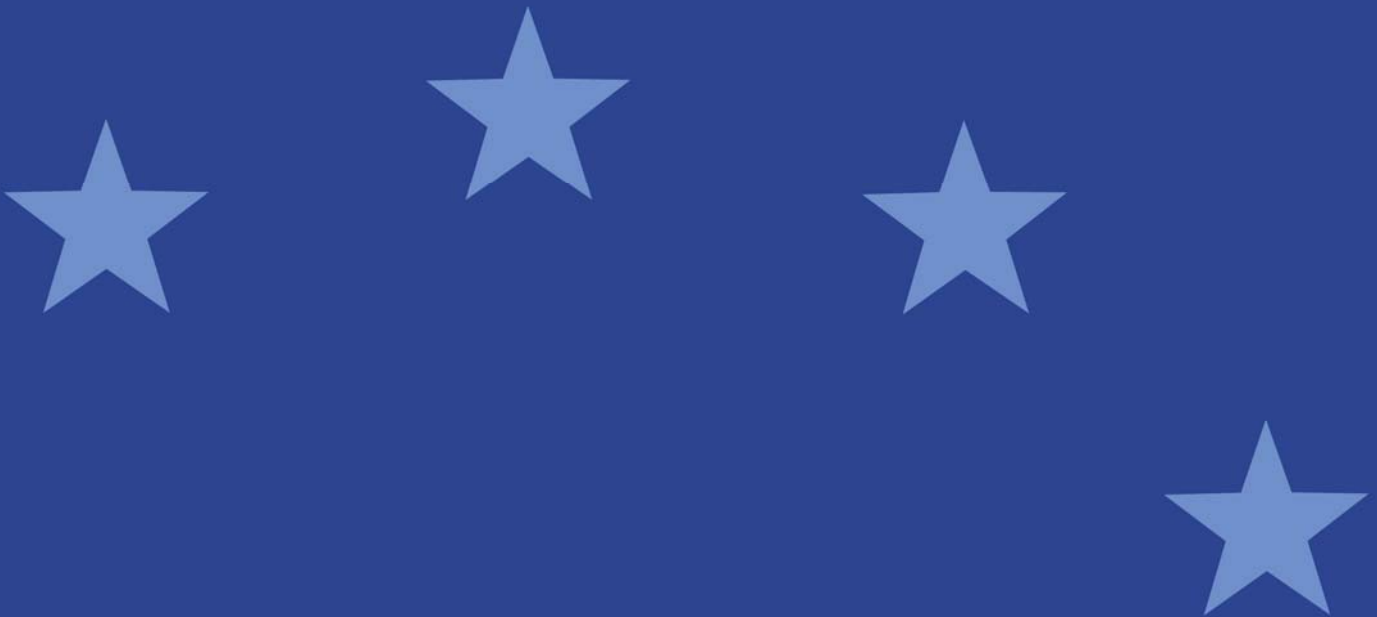


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Executive Summary

Reasons for publication

The European Commission (the Commission) sent a formal request to ESMA to provide technical advice to assist the Commission in formulating a Regulation on fees for Credit Rating Agencies (CRAs) by delegated act (please, find in Annex II a copy of the Commission's formal request). The advice was due to be delivered to the Commission by 13 May 2011. On 14 April 2011, ESMA released a consultation to receive industry input in order to assist it in providing advice to the European Commission.

In order to deliver its advice to the Commission, ESMA considered possible fee structures for CRAs registered or certified in the EU and for CRAs seeking registration or certification. In order to finalise the advice by the due deadline, ESMA decided it was appropriate to conduct a shortened consultation on these possible structures in order to enable it to deliver robust advice to the Commission.

Contents

ESMA has considered the feedback it received to the consultation in providing its technical advice to the Commission. This document sets out a summary of the responses received by ESMA regarding the fee structure for CRA supervision and registration in the EU and includes ESMA's advice to the Commission on technical aspects of the future Regulation on fees for CRAS which will be adopted by the Commission in the form of a delegated act (Annex I).

Next steps

ESMA will follow-up on this work with the Commission regarding a concrete proposal on the level of fees to be charged for applications for registration and certification, as well as on the method for claiming back the costs of CRA supervision from 1 July 2011 to 31 December 2011.

II. Introduction

1. On 24 February 2011 ESMA received a formal request from the European Commission (the Commission) to provide technical advice to assist the Commission in formulating a Regulation on fees for CRAs by delegated act. The advice was due to be delivered to the Commission by 13 May 2011.
2. In order to provide this advice ESMA, conducted a consultation on the options it was considering for the advice. Given the time period established for providing this advice, ESMA was compelled to require responses to the consultation within a short timeframe.
3. In total, ESMA received 8 responses to the consultation. Non-confidential responses can be found on ESMA's website. ESMA would like to thank respondents for providing input given the short period ESMA was able to consult for.
4. This final report analyses the responses to the public consultation conducted and includes in Annex I ESMA's Technical Advice to the Commission on fees for CRA registration and supervision.

III. Supervisory Fees for EU registered CRAs

5. ESMA indicated it had considered two basic methods of raising fees in order to prepare its consultation.
 - Periodic fees; and
 - Activity specific fees.
6. Furthermore, ESMA indicated that having considered these methods it was inclined to suggest a simple, periodic fee based on the total cost of CRA supervision and the ratio of a CRA's turnover in relation to the total turnover of EU CRA's.
7. We asked:

Q1: Do you agree with ESMA's preferred option to raise a periodic supervisory fee? Do you agree with the proposed fee calculation method to ensure that the fee is proportionate to the turnover of the CRA?

8. There was general support for the implementation of a periodic supervisory fee structure without activity specific fees. There were, however, a number of comments on the method of calculation suggested. The two main concerns expressed over the method of calculation were the potential impact on competition of the fees and the inclusion of non-rating activity related revenue in the fee calculation itself.
9. A number of respondents indicated that they were of the view that the method of calculation might impact negatively on competition. A variety of reasons were given for this, for example the method of calculation did not recognise the additional value to global CRAs of their non-EU rating activity and its use in financial regulations and that smaller CRAs have a greater ratio of fixed costs to turnover. Possible solutions suggested included creating bands of possible fees relating to business complexity (as considered under the registration fee section of the consultation), including turnover re-

lating to endorsed ratings and/or introducing a fee cap – either a maximum percentage of turnover or a set amount for small CRAs.

10. Several respondents indicated that fees should be based purely on turnover-relating to rating activity as this would not prevent new entrants from entering the credit rating industry from other sectors.
11. One respondent indicated concerns over the planning process for the fee calculation as this may prevent smaller CRAs having clarity on their forthcoming supervisory costs.
12. *ESMA continues to believe that a periodic fee based on total turnover (including rating and non-rating activities) is appropriate. In relation to the concern raised that the fees based on the total turnover could penalise small sized CRAs which are growing their credit rating business, although ESMA understands the nature of the argument, ESMA points out that the cost of supervision of CRAs providing non-rating (ancillary) services is likely to be higher because of potential conflicts of interest arising from the provision of non-rating activities. In light of this, ESMA is of the view that the total turnover would be a more proportionate basis for the calculation of the supervisory fees. In any case, the risk highlighted in certain responses is mitigated by the fact that both large and small CRAs carry out non-rating activities.*
13. *In its advice ESMA suggests the Commission considers when constructing the fee regime whether there are any precautions that need to be taken to prevent the reallocation of revenue within global CRA groups in order to reduce their fee contributions.*
14. We asked:

Q2: Do you agree that the minimum supervisory fee is established within the range of 2,000 – 5,000 euros?

15. There was a mixed response to the proposal for a minimum supervisory fee. Supporters considered it important that CRAs contributed appropriately to the cost of their supervision. Others indicated that the fixed amount was too high for smaller CRAs and could act to prevent competition.
16. Of the respondents supporting a minimum fee two questioned whether the fee would appropriately cover the cost of supervision for even the smallest of CRAs.
17. Possible solutions put forward by respondents concerned by the cost of the minimum fee to smaller CRAs were – to set a maximum fee based on a percentage of turnover (no percentage was suggested) or to set a lower minimum cost but to charge this per office of the CRA in the EU.
18. *ESMA recognises that there is a need to balance the risks of fees to competition against the need for CRAs to contribute proportionately to the cost of their supervision. ESMA continues to consider a minimum fee is appropriate given all CRAs, no matter their size, will require ESMA to expend supervisory resources. ESMA is mindful of the ability of smaller CRAs to bear a higher fee than 5.000 euros, on the other hand, a lower fee could force large CRAs to subsidise the fees of smaller CRAs; consequently, ESMA suggests the minimum fee to be set at 5.000 euros.*
19. *ESMA does not recommend establishing of a maximum fee as this would limit ESMA's ability to charge fees in a proportionate manner. As previously stated, the extent to which big CRAs subsidise smaller CRAs, if at all, should be carefully considered by the Commission given the potential*

impact on competition. In any case, given the significant difference in the level the turnover of small CRAs compared to the turnover of the medium-sized and biggest CRAs, ESMA would not expect small CRAs to pay fees significantly in excess of the minimum fee.

Turnover calculation

20. ESMA indicated in the consultation that the full turnover of the CRA should be used to enable calculations to be conducted using fully audited accounts. ESMA recognised that within global groups there might be some potential to channel turnover and this would be considered before delivering advice to the Commission.
21. Turnover for fee charging purposes would be determined by taking the figure for turnover/revenue from the most recent audited accounts of the CRA.
22. ESMA considered two possible ways to deal with a situation in which no audited accounts were available – a minimum set fee or a request for interim accounts.
23. We asked:

Q3: In case that audited revenues are not available, what should be the basis for calculation of the supervisory fees?

24. There was some support from respondents for using interim accounts but a greater number indicated concerns over this approach. In particular the burden of producing interim accounts in time to be considered in the fee calculations was highlighted. A possible solution put forward by three respondents was to use the latest set of audited accounts available to calculate a first fee payment (i.e. 2010 accounts for 2012 fees), the transparency report figure of turnover or the financial data that registered CRAs will be required to provide to ESMA on periodic basis. The second fee payment would be calculated, using the audited accounts from the previous year (i.e. 2011 accounts for 2012 fees) to make the total annual fee payment from the CRA proportionate to its share of total EU CRA turnover for the previous year.
25. *Having considered the feedback received, ESMA suggests that the audited accounts are used as the basis for the calculation of the annual supervisory fees. ESMA supports the concept of splitting the payment of the annual supervisory into two instalments (please, read below in section VI). For the first payment, the audited accounts might not be available, therefore, the first payment could be calculated based on the turnover stated in the last accounts. Once the audited accounts are published, and in order to calculate the second payment, the audited total turnover would be used. The amount to be paid in the second instalment should take into account the amount already paid in the first instalment.*
26. *This would mean that the total supervisory fee for the annual period would be determined purely from the last set of audited accounts; however an initial instalment would be estimated using available figures.*
27. *ESMA has given consideration to how fees should be calculated for supervision during the first year when a CRA is registered and the year following the registration (as there is a high likelihood that new CRAs will not have a full year's worth of revenue in their accounts for the following year). For the proportion of the year where the CRA is registered, ESMA's advice is to charge a percentage of the minimum supervisory fee proportionate months of the ESMA financial year re-*

maintaining following the registration. For the year following the registration, projections of the “annual” total turnover of the CRA should be used to calculate the proportion of the ESMA CRA budget to be allocated to the new CRA.

28. *For instance, if the CRA was registered in month x of year n , the supervisory fee for year n would amount at: minimum supervisory fee * $(12-x)/12$. The supervisory fee for year $n+1$ would be: ESMA CRA budget $n+1$ * [revenue of the CRA in year n * $12 / (12-y)$] / all CRAs revenue in year n . Where y is the month at which the accounts of the CRA began (e.g. for September $y=9$).*

IV. Certified CRAs

29. Given the certification of a CRA and ongoing interactions with third country regulators ESMA indicated in the consultation that it was considering advising the Commission to introduce a fee for certification applications and an annual fee for certified CRAs.

30. We asked:

Q4: Do you agree that a flat fee for certification applications is established within the range of 2,000 – 15,000 euros?

Q5: Do you agree that an annual flat supervisory fee for certified CRAs is established within the range of 2,000 – 5,000 euros? If the CRA is certified during the course of the year, do you agree to charge this supervisory fee on a pro-rata basis?

31. No certified CRAs responded to the consultation and some respondents chose not to comment on these questions. Of the respondents that did address these questions more agreed with ESMA's proposals than disagreed. No respondent disagreed with the introduction of certification fees, however some disagreed with the amounts as they considered that these fees should either not be flat fees or that they were too low in comparison to registration and supervision fees of EU CRAs.

32. *ESMA suggests that there should be a fee for certification applications which should be between 2,000-15,000 euros. Regarding the supervisory fee for certified CRAs, ESMA suggests to set the fee at 5,000 euros as ESMA estimates that the cost of desk-based revision of periodic supervisory information received from a certified CRA would be similar to the supervision of a CRA with a limited rating activity.*

V. Registration Fees

33. ESMA indicated that it was considering two potential options for registration fees:

- A flat fee for all new registrations; or
- Different bands of registration fees based on objective factors.

34. ESMA set-out in the feedback statement its views of the costs and benefits of the two options above and indicated that at the time of consultation it considered the creation of different bands of registration fees more appropriate than a flat fee as this would better align the fee with the likely cost of the registration process and create a more proportionate framework.

35. ESMA also highlighted that it was considering the appropriateness of levying a fee for supervision on the completion of the application process given that supervision of the firm will need to start at this time.
 36. ESMA highlighted that the suggested ranges should not be interpreted as ESMA's proposal to have the discretion to define the exact amount of fees within the bands. At this stage, ESMA is still in the process of defining concrete fees within each band.
 37. We asked:
- Q6: Do you agree with the criteria ESMA is considering for establishing the fee bands (i.e. type of credit ratings (structured finance instruments), existence of branches and use of endorsement)? Do you agree with the criteria ESMA is considering to establish the exact fee amounts within the bands (i.e. number of employees)?**
38. Responses fell into three categories – some agreed with ESMA, some agreed to the establishment of bands but considered the fees were too high in the lower bands and some considered that although the fees should be proportionate to the size of the CRA the bands were created using inappropriate criteria. One respondent suggested including the “systemic importance” of the rating agency as a criteria for establishing the bands.
 39. Proposals for alternate ways of calculating fees for registration included using an estimate of turnover or doubling the supervisory fee for the first year to cover the registration costs.
 40. *ESMA has considered the responses and suggests the registration fees be established within the bands proposed in its consultation paper, that is:*
 - *Band A for applicant CRAs not issuing ratings for structured finance instruments, with no branches neither plans to endorse ratings: 2,000 - 30,000 euros*
 - *Band B for applicant CRAs which meet one of the following criteria: issuing ratings for structured finance instruments or having branches or planning to endorse ratings: 10,000 - 100,000 euros*
 - *Band C for applicant CRAs which meet at least two of the three following criteria: the CRA has established branches, issues structured finance ratings and plans to endorse ratings: 30,000 - 150,000 euros*
 41. *ESMA advises the Commission to set different bands for the registration fees using the following criteria to establish the bands: type of credit ratings (structured finance instruments), existence of branches and use of endorsement. We do not suggest including systemic importance as one of the factors to be considered in establishing the bands because only very objective criteria should be used to define the bands to avoid complication in assessment and clarity to potential applicants.*
 42. *As ESMA should not have the discretion to define the exact amount of fees within the bands, ESMA suggest that if this approach is taken the concrete amount could be defined according to the number of employees of the CRA as a proxy for its turnover. ESMA is willing to provide further advice on the how the number of employees should impact the fee if required.*

43. Based on the experience of the competent authorities of the home Member States which are dealing with the registration applications, in the consultation paper ESMA consulted on the reimbursement of registration fees in the case of withdrawal of the application for registration.
44. ESMA proposed that if the application is withdrawn before the completeness check had been concluded, the CRAs would be granted a reimbursement of $\frac{3}{4}$ of the initial fee. If the application is withdrawn after this point, they would be granted a reimbursement of $\frac{1}{4}$ of the initial fee.
45. We asked:

Q7: Do you agree that the registration fee is partly reimbursed in case of withdrawal of the application? Do you agree with the reimbursement proportions which ESMA is considering for its advice?

46. All respondents that addressed this issue agreed with ESMA.
47. *ESMA suggests that the Commission includes a clause to allow the reimbursement to CRAs as suggested in the consultation.*

VI. Calculation Period and Collection of Fees

48. In the consultation ESMA highlighted that it operates on a budgeting year from January to December and it would propose in its advice that the fee period is based on this period. The ESMA budget is only approved at the end of the year by the Parliament and Council.
49. ESMA indicated that it was considering whether to advise the Commission to have one fee collection at the start of the year of two collections during the year.
50. We asked:

Q8: Would you be in favour that the supervisory fees are paid in one single payment per year (option 1) or in two payments per year (option 2)? Would you agree with the proposed dates?

51. All respondents, except one, that provided an answer to this question preferred two instalments. As mentioned earlier some considered the use of two payment dates would allow ESMA to use the second fee to ensure that the total annual fee was calculated using the audited turnover of the previous year.
52. Three respondents suggested the two instalments to take place in June and December, another respondent proposed September and December.
53. *Having considered the feedback ESMA suggests to the Commission that the annual supervisory fee is paid in two instalments, the first one before the end of February and the second one by the end of September. $\frac{2}{3}$ of the estimated annual supervisory fee would be paid in the first instalment. The basis of calculation of the final annual fee should be the audited accounts. However, in the event the audited accounts are not available when the amount of the first instalment is determined, the basis of calculation of the fees for the first instalment would be the last set of accounts*

as previously mentioned. Differences accrued by using the previous accounts will be adjusted within the calculation of the second instalment.

VII. 2011 Fees

54. ESMA indicated that it will provide advice to the Commission on raising fees for the 1 July 2011 to end 2011 period as requested. One respondent highlighted that the Commission impact assessment accompanying proposals to amend the CRA Regulation envisaged costs being covered by the Community budget. Another respondent indicated that the Frequently Asked Questions – A Guide to Understanding ESMA (3rd January 2011) stated that the ‘costs of implementing the CRA Regulation will be financed via industry fees and levies from 2012.’ The same respondent highlighted that if any fees are charged for 2011 they should only cover the period from 1st July 2011.
55. *ESMA was requested to consider how fees for 2011 supervision could be charged. ESMA is not yet in a position to provide advice to the Commission on the method to claim back the costs of the CRA supervision from 1 July 2011 to 31 December 2011 as ESMA has not yet finalised its analysis of how to deal with any surplus in the 2011 CRA supervisory budget given the fact that the full 2011 CRA budget was pre-funded by the Member States and ESMA.*

VIII. 2012 Fees

56. ESMA indicated that the budget for CRA supervision has been proposed as 3 million euros for this period. Therefore, ESMA was intending to recommend that the fees to cover this amount are based on a simple calculation using the relative turnover of registered CRAs in the last set of audited accounts as of 31 December 2011 compared to the total turnover of all registered CRAs. ESMA indicated that the payment schedule for these fees should follow the approach taken for supervisory fees going forward.
57. One respondent highlighted that the expected budget for CRA supervision in the Commission impact assessment for the Regulation amendments was 2.5 million euros and indicated the need for ESMA to keep its budget sufficiently controlled and commensurate to the tasks assigned.
58. *ESMA recommends to the Commission that 2012 fees should be calculated on the same basis as suggested for the annual supervision fees for any other year. This should be calculated based on the final budget for CRA supervision approved by the European Parliament and the Council of the European Union. ESMA highlights the 2.5 million euros stated in the Commission impact assessment was an estimate and that ESMA expects the final budget to be in the region on 3 million euros.*

IX. Surplus/deficit management

59. ESMA highlighted in its consultation that it was engaged in discussions about the appropriate treatment of budgeting surpluses or deficits with the relevant EU bodies. One respondent highlighted that if there was any surplus this should be dealt with by an appropriate and proportionate reduction in fees for the following year.
60. *At the current time, the necessary discussions with EU bodies on the necessary budgetary approach have yet to be concluded. Therefore, in its advice ESMA is only in a position to recommend some principles behind dealing with fee surplus/deficits.*



Annex I: ESMA's Technical Advice to the Commission on Fees for the supervision and registration of CRAs

I. Background

1. On 24 February 2011 ESMA received a formal request from the European Commission (the Commission) to provide technical advice to assist the Commission in formulating a Regulation on fees for CRAs by delegated act. The advice was due to be delivered to the Commission by 13 May 2011.
2. ESMA considered possible fee structures for CRAs registered in the EU and for CRAs seeking registration. Since the approach which the Commission adopts to fees may have material implications on the supervisory and administrative costs associated with registration and certification, ESMA considered it necessary to conduct a consultation on these possible structures in order to deliver robust advice to the Commission. ESMA consulted the market participants on 14 April 2011. Given the time period established for providing its advice, ESMA conducted a short public consultation closing on 27 April 2011.
3. ESMA has made a preliminary assessment of the cost of carrying out the different actions for which it is considering to propose charging certification, registration and minimum fees for the supervision of registered and certified CRAs. ESMA has in addition considered the fees levied by certain competent authorities of the home Member States currently responsible for the registration and supervision of the CRAs. The figures provided in this Technical Advice have been calculated based on a preliminary assessment of the cost to ESMA of carrying out the relevant actions (minimal supervision, certification and registration).
4. For its advice, ESMA has considered the amendments to the CRA Regulation 1060/2009/EC (the Regulation) agreed by the EU Parliament and the Council of the European Union which provide that supervisory fees must cover all administrative costs and be proportionate to the turnover of CRA concerned.

In this Technical Advice ESMA proposes the following:

- For on-going supervisory fees of registered CRAs, ESMA suggests a single periodic fee based on the total turnover of the CRA relative to the total turnover of all CRAs registered in the EU. ESMA has explored the technicalities of the calculation of the annual supervisory fees, in particular, the appropriate method for considering the turnover of the CRAs and the periodicity of the payments. In this respect, ESMA suggests that the basis of calculation of the annual supervisory fee is the total turnover (including rating and non-rating activities) published in the audited accounts. ESMA proposes that the payment of the annual fees is divided into two instalments, the first one should be payable by the end of February, the second one, by the end of September.
- For registration fees to be charged to applicant CRAs, ESMA proposes different registration flat fee bands based on objective criteria for assessing the complexity of the application. ESMA has explored objective criteria that would define the fee bands. ESMA proposes that the concrete

¹ Consultation paper - ESMA's Technical Advice to the Commission on Fees for CRA Supervision. ESMA/2011/114.

amounts charged to CRAs should depend on the number of employees of the applicant (as a proxy for the expected turnover).

- ESMA suggests a flat fee for both applications for certification and the supervision of certified CRAs.

II. Periodic supervisory fees for registered CRAs

5. ESMA proposes a single supervisory periodic fee as it considers that a periodic supervisory fee is simpler to calculate and implement than activity specific fees. Furthermore, annual supervisory fees create more budgeting certainty for CRAs than activity specific fees. Periodic fees may be more prone to leading to under or over-charging CRAs, ESMA has given consideration to the allocation of any surpluses arisen from the ESMA audited budgets as explained below.

a) Annual supervisory fee

6. For registered CRAs, ESMA proposes to charge a periodic fee proportionate to the total turnover of the CRA compared to the total turnover of all registered CRAs.
7. The fees to be charged by ESMA as per the amended CRA Regulation shall fully cover ESMA's necessary expenditure relating to the registration and supervision of credit rating agencies. The total resourcing budget for ESMA supervisory activities is established in the annual budget which is approved by the European Parliament and the Council of the European Union. The budget for CRA supervision would include flexibility for ad-hoc tasks, investigations and delegated activities. ESMA proposes that the approved budget is the basis for the calculation of the annual supervisory fees for registered CRAs.
8. Each CRA would be charged a percentage of the total budget which ESMA has allocated for CRA supervision. The percentage would be based on the ratio of the CRA's applicable turnover to the total applicable turnover of all registered CRAs.

Annual fee for a CRA in year n+1 = ESMA's CRA approved budget for n+1 year (minus any *fixed fees*)² * total turnover of CRA in year n / total turnover of all CRAs in year n

Fixed fees would include the supervisory fees for certified CRAs and any minimum supervisory fees to be charged. In the event any CRAs are subject to the minimum supervisory fee, this would need to be reflected in the final calculation. The fees charged to certified CRAs for their supervision should be deducted as well.

b) Total turnover published in the most recent audited accounts

9. For the purpose of charging the annual supervisory fees, the total turnover would be determined by total revenues (turnover) published in the most recent audited accounts of the CRA. ESMA rejected the option to use the turnover exclusively from rating activities for the calculation of the proportion of ESMA's CRA budget to be allocated to the individual CRAs because fees should be proportionate

to the higher cost of supervision of CRAs providing non-rating (ancillary) services for which ESMA has to supervise the conflicts of interest arising from the provision of non-rating activities. According to the amended CRA Regulation, the fees must cover all administrative costs.

10. ESMA suggests the Commission considers when constructing the fee regime whether there are any precautions that need to be taken to prevent the reallocation of revenue within global CRA groups in order to reduce their fee contributions.

c) Payment of the annual fee in two instalments

11. ESMA suggests that the annual supervisory fee is payable in two instalments as to assist the CRAs in the financial management of the fee and permit adjustments in the second payment with respect to the turnover published in the most recently audited accounts and any surplus in the ESMA CRA budget following the annual audit of the budget in May, if this method of redistribution of the surplus were adopted (please, refer to letter e) below).
12. ESMA suggests that the first payment is due by the end of February, the second one by the end of September. 2/3 of the estimated annual supervisory fee should be charged in the first instalment as to ensure that ESMA's expenses on CRA supervision are correlated with the CRA fees income. ESMA proposes the following framework for fee collection:

First instalment

13. The amount due for the first instalment would correspond to 2/3 of the fee calculated as indicated in paragraph 8. ESMA should calculate the amount due in early January. It is probable that the previous year audited accounts of certain CRAs are not available. In this event, the basis of calculation of the estimated supervisory annual fees in paragraph 8 would be the total turnover of the last set of accounts which is available for ESMA on January 1st.
14. From the receipt of ESMA's invoice, the CRAs should be granted a period of 20 working days to make their first payment. ESMA should send the invoice to the CRAs before the end of January so that the first instalment is paid by the end of February.

Second instalment

15. In early August, when it is expected that the previous year accounts are published, ESMA should calculate the annual supervisory fee using the figure for turnover/revenue from the most recent audited accounts of the CRA available for ESMA on August 1st as an input for the calculation suggested in paragraph 8.
16. The individual payment due for a CRA in the second instalment would amount at the annual fee calculated as per paragraph 8 using the turnover/revenue from the most recent audited accounts, minus the fees charged in the first instalment according to paragraph 13 and any previous year surplus in the CRA budget allocated to the CRA (if applicable, see letter d)).
17. From the receipt of ESMA's invoice, the CRAs should be granted a period of 20 working days to make their second payment. ESMA should send the invoice to the CRAs before the end of August so that the second instalment is paid by the end of September.

18. ESMA recommends the Commission gives consideration to the situations where the CRA is over-charged in first payment, that is, the amount due under paragraph 13 for the first instalment is higher than the annual supervisory fee calculated with turnover of the most recent audited accounts following paragraph 15 (i.e., in cases where the revenues of a CRA have dramatically decreased).

d) Management of a given year surplus in the budget

19. ESMA has given consideration to the event that, following the annual audit of the ESMA, a surplus in the budget allocated to the CRA activities arises.
20. At the current time, the necessary discussions with EU bodies on the necessary budgetary approach have yet to be concluded. Therefore, ESMA is only in a position to recommend some principles behind dealing with fee surplus/deficits.
21. ESMA suggests that any surplus of fees should be not be used to subsidise ESMA's non-CRA related activities and do not believe this approach would be in line with the CRA Regulation. Therefore ESMA recommends that in constructing a suitable fee regime the Commission fully investigates measures to:
 - Ensure that the legal framework allows ESMA to redistribute any surplus in the ESMA budget relating to a difference between the costs resulting from supervision of CRAs and the fees raised for this specific activity from the industry; and
 - Ensure that any such redistribution is conducted in such a way to be proportionate to the fees paid by individual CRAs in the surplus year.
22. ESMA would highlight the following potential scenario, as an example of how the above principles could be adhered to. In the event that following the audit of 2012 ESMA's budget a surplus in the CRA budget is discovered, the surplus should be deducted from 2013 CRA fees. The amount to be deducted would be calculated on the basis of the proportion of total fees claimed by ESMA in 2012 that were paid by the specific CRA. The individual surplus calculated in such a way would be deducted from the second instalment of 2013 fees.

e) Minimum fee

23. Even if a CRA does not publish any revenue in a given year, ESMA will carry out periodic on-going supervisory tasks in respect to this CRA as long as it is registered. ESMA proposes to set a minimum fee to cover these periodic on-going supervisory tasks so as to avoid other CRAs subsidising this cost.
24. ESMA is mindful of the ability of smaller CRAs to bear a higher fee than 5.000 euros. On the other hand, if a lower fee were set, the risk emerges that larger CRAs subsidise the cost of supervising smaller CRAs. Consequently, ESMA suggests the minimum fee to be set at 5.000 euros.
25. ESMA highlights that the introduction of a minimum fee would require a recalculation of other registered CRA fees for the year (as they would have to pay marginally less than without the minimum fee). Therefore there would need to be two calculation rounds for determining fees.

f) Supervisory fee for recently registered CRAs

26. ESMA has considered the supervisory fees to be charged for the year when the CRA is registered. For the proportion of the year where the CRA is registered, ESMA's advice is to charge a percentage of the minimum supervisory fee proportionate to the months where the CRA is effectively supervised that year after its registration. The supervisory fee would be payable at the point of registration. For instance, if the CRA was registered in month x of year n, the supervisory fee for this year would amount at:

Supervisory fee for year n = minimum supervisory fee * (12-x)/12.

27. For the annual supervisory fee of the year following the registration, the annual turnover of the CRA to be used in the calculation of the percentage of the CRA budget may need to be estimated by an annual projection of the audited revenue in the previous year if the firm did not generate revenue for the full year. If the CRA only gathers revenue from month x of the year n, the supervisory fee for year n+1 would be:

Supervisory fee for year n+1 = ESMA CRA budget n+1 * [total revenue of the CRA in year n * 12 / (12-x)] / total revenue of all CRAs in year n.

III. Fees for CRAs applying for Registration

a) Applications for Registration fees

28. ESMA proposes a banded approach to registration fees with the purpose of associating the registration fee with the expected cost of the different types of registration applications in a more proportionate way than a flat fee for all kinds of registration applications.
29. ESMA has established the following bands for the registration fees which intend to reflect the complexity of the applications:
- Band A for applicant CRAs not issuing ratings for structured finance instruments, with no branches neither plans to endorse ratings: 2,000 - 30,000 euros
 - Band B for applicant CRAs which meet one of the following criteria: issuing ratings for structured finance instruments or having branches or planning to endorse ratings: 10,000 - 100,000 euros
 - Band C for applicant CRAs which meet at least two of the three following criteria: the CRA has established branches, issues structured finance ratings and plans to endorse ratings: 30,000 - 150,000 euros
30. ESMA should not have any discretion to define the exact amount of fees within the bands. The concrete registration fee amount for a particular application should reflect the probable turnover of the applicant. In cases where the turnover of the applicants cannot be used as the basis of calculation because it is a newly established firm, ESMA proposes to use the number of employees as a proxy for turnover.
31. At this stage, ESMA is not yet in a position to provide the exact figures to be charged per type of application. The following chart intends to summarise ESMA's proposal:

Registration fees per complexity of the application and size of the applicant

	CRAs not issuing ratings for structured finance instruments, with no branches neither plans to endorse ratings	CRAs which meet one of the following criteria: issuing ratings for structured finance instruments or having branches or planning to endorse ratings	CRAs which meet at least two of the three following criteria: the CRA has established branches, issues structured finance ratings and plans to endorse ratings
Less than x employees	Not yet calculated (the exact amount should be close to the low in the range of 2,000 – 30,000 euros)	Not yet calculated (the exact amount should be close to the low in the range of 10,000 – 100,000 euros)	Not yet calculated (the exact amount should be close to the low in the range of 30,000 – 150,000 euros)
Between x and y employees	Not yet calculated (the amount should be established within the range of 2,000 – 30,000 euros)	Not yet calculated (the amount should be established within the range of 10,000 – 100,000 euros)	Not yet calculated (the amount should be established within the range of 30,000 – 150,000 euros)
More than y employees	Not yet calculated (the exact amount should be in close to the high in the range of 2,000 – 30,000 euros)	Not yet calculated (the exact amount should be in close to the high in the range of 10,000 – 100,000 euros)	Not yet calculated (the exact amount should be in close to the high in the range of 30,000 – 150,000 euros)

32. In cases where a group of CRAs make an application, registration fees will be charged to individual applicants.

b) Withdrawals of Registration applications

33. ESMA has given consideration to what should be done if an application is withdrawn before the process is complete and whether there should be the reimbursement of any of the fee.

34. Based on the experience of the competent authorities of the home Member States which are dealing with registration applications, ESMA proposes that if the application is withdrawn before the completeness check has been completed, the CRAs should be granted a reimbursement of $\frac{3}{4}$ of the initial fee. If the application is withdrawn after this point, they would be granted a reimbursement of $\frac{1}{4}$ of the initial fee.

IV. Fees with respect to Certification

a) Applications for Certification fees

35. ESMA is considering recommending a flat fee for processing an application for certification. The amount of the fee would correspond to the cost of the average resources ESMA expects to dedicate to processing the application for registration. ESMA estimates that the cost would be around 2,000-15,000 euros although it is not yet in a position to advise the Commission on a concrete figure.

b) Certified CRAs supervision fees

36. Although the level of supervisory work associated with certified CRAs is very limited in comparison with registered CRAs, it is not negligible. ESMA estimates that the cost of the desk-based revision of periodic supervisory information received from a certified CRA and the on-going interactions with third-country regulators would be similar to the supervision of a CRA with a limited rating activity.
37. ESMA is of the opinion that the turnover of a certified third country CRA is not relevant for the calculation of supervision fees for certified CRAs. Therefore, ESMA suggests charging an annual flat fee based on the estimated cost of supervision of certified CRAs which is expected to be close to the minimum supervisory fee, that is, 5,000 euros. This figure would be subtracted from the total ESMA CRA budget prior to performing the calculation in paragraph 8 above.
38. When a CRA is certified during the course of the year, this annual fee would be pro-rated and charged at the point of certification.

V. Next Steps

39. ESMA will follow-up with the Commission on the concrete amount of fees to be charged for the applications for registration and certification. To this end, ESMA will continue its internal cost analysis and will take into account the experience of the home Competent Authorities.
40. Once the assessment of the budgetary implications of collecting fees corresponding to the second half of 2011 ESMA's supervisory tasks has been concluded, ESMA will follow-up with the Commission on the method for claiming back the costs of the CRA supervision from 1 July 2011 to 31 December 2011.

Annex II: European Commission request to ESMA for technical advice on possible delegated acts concerning the amended CRA Regulation

FORMAL REQUEST TO ESMA FOR TECHNICAL ADVICE ON POSSIBLE DELEGATED ACTS CONCERNING THE AMENDED CRA REGULATION (1060/2009/EC)

With this formal mandate the Commission seeks ESMA's technical advice on possible delegated acts concerning the amended CRA Regulation (the "**Amended Regulation**"). These delegated acts should be adopted in accordance with Article 290 of the Treaty on the Functioning of the European Union (TFEU).

The Commission reserves the right to revise and/or supplement this formal mandate. The technical advice received on the basis of this mandate should not prejudice the Commission's final decision.

The mandate follows the Regulation of the European Parliament and the Council establishing a European Securities and Markets Authority (the "**ESMA Regulation**"),¹ the Communication from the Commission to the European Parliament and the Council – Implementation of Article 290 of the Treaty on the Functioning of the European Union (the "**290 Communication**"),² and the Framework Agreement on Relations between the European Parliament and the European Commission (the "**Framework Agreement**").³

According to Article 19 (2) of the amended Regulation the Commission shall adopt by means of a delegated act a regulation on fees. That regulation shall determine in particular the type of fees and the matters for which fees are due, the amount of the fees, the way in which they are to be paid and the way in which ESMA shall reimburse competent authorities in respect of any costs they may incur carrying out work under the amended Regulation, in particular as a result of a delegation of tasks according to Article 30. Part I of this mandate focuses on technical issues related to this Regulation on fees.

The European Parliament and the Council shall be duly informed about this mandate.

In accordance with the Declaration 39 on Article 290 TFEU, annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December 2007, and in accordance with the established practice within the European Securities Committee,⁴ the Commission will continue to consult experts appointed by the Member States in the preparation of possible delegated acts in the financial services area.

In accordance with point 15 of the Framework Agreement, the Commission will provide full information and documentation on its meetings with national experts within the framework of its work on the preparation and implementation of Union legislation, including soft law and delegated acts. Upon request by the Parliament, the Commission may also invite Parliament's experts to attend those meetings.

The powers of the Commission to adopt delegated acts are subject to Articles 38a-c of the Amended Regulation. As soon as the Commission adopts a possible delegated act, the Commission will notify it simultaneously to the European Parliament and the Council.

1. Context.

1.1 Scope.

On 2 June 2010, the Commission published its proposal for amendments to the CRA Regulation⁵. On 15 December 2010 a political agreement was reached by the European

¹ 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), OJ L 331, 84 15.12.2010.

² Communication of 9.12.2009. COM (2009) 673 final.

³ OJ L304/47, 20.11.2010, p. 47-62.

⁴ Commission's Decision of 6.6.2001 establishing the European Securities Committee, OJ L191, 17.7.2001, p.45-46.

⁵ Proposal for a Regulation of the European parliament and the Council on amending Regulation (EC) No 1060/2009 on credit rating agencies, COM(2010)289

Parliament and the Council on a compromise text. The text is expected to be formally adopted by the European Parliament and the Council in March 2011. Publication in the Official Journal is expected by April 2011 and the Regulation will enter into force on the twentieth day following its publication.

The main objective of the amending Regulation is to grant the European Securities and Markets Authority (ESMA) direct supervisory powers over credit rating agencies (CRAs) that are active in the EU. To this aim, the power to register and supervise CRAs that is under the current CRA Regulation with national competent authorities will be entrusted to ESMA which will be solely responsible for the supervision of CRAs as of July 2011. Consequently, also the right to levy fees to CRAs will be shifted from national competent authorities to ESMA pursuant to Article 19 of the amended Regulation. ESMA will be the only authority to charge fees for registering and supervising CRAs and will base its claims on a Regulation on fees to be adopted by the Commission in the form of a delegated act.

This mandate focuses on the technical aspects of this Regulation on fees, including specifying the matters for which fees should be due and the amount of the fees. In providing its advice ESMA should profit from the experience of national competent authorities in setting supervisory fees.

1.2 Principles that ESMA should take into account.

On the working approach, ESMA is invited to take account of the following principles:

- It should respect the requirements of the ESMA Regulation, and, to the extent that ESMA takes over the tasks of CESR in accordance with Art 8(1)(l) of the ESMA Regulation, take account of the principles set out in the Lamfalussy Report and those mentioned in the Stockholm Resolution of 23 March 2001.
- The principle of proportionality: the technical advice should not go beyond what is necessary to achieve the objective of the amended Regulation. It should be simple and avoid creating excessive financial, administrative or procedural burdens for CRAs.
- The technical advice should take account of the rule-of-law principle which requires appropriate rights of defense for persons that are subject to ESMA's supervision. At the same time, it should ensure a high level of investor protection which is a guiding principle of EU financial regulation and requires a strong supervisor with the power to carry out supervision and ensuring compliance with the CRA Regulation in an effective and efficient way.
- While preparing its advice, ESMA should seek coherence within the regulatory framework of the Union.
- In accordance with the ESMA Regulation, ESMA should not feel confined in its reflection to elements that it considers should be addressed by the delegated acts but, if it finds it appropriate, it may indicate guidelines and recommendations that it believes should accompany the delegated acts to better ensure their effectiveness.
- ESMA will determine its own working methods depending on the content of the provisions being dealt with. Nevertheless, horizontal questions should be dealt with in

such a way as to ensure coherence between different standards of work being carried out by the various expert groups.

- In accordance with the ESMA Regulation, ESMA should, where relevant, involve the European Banking Authority and the European Insurance and Occupational Pensions Authority in order to ensure cross-sectoral consistency. It should also cooperate with the European Systemic Risk Board on any issues related to systemic risk.
- In accordance with the ESMA Regulation, ESMA is invited to widely consult market participants (practitioners, consumers and end-users) in an open and transparent manner. ESMA should provide a feed-back statement on the consultation justifying its choices vis-à-vis the main arguments raised during the consultation.
- The technical advice carried out should contain sufficient and detailed explanations for the assessment done, and be presented in an easily understandable language respecting current legal terminology at European level.
- ESMA should provide comprehensive technical analysis on the subject matters described below covered by the delegated powers included in the relevant provision of the amended Regulation, in the corresponding recitals as well as in the relevant Commission's request included in this mandate.
- The technical advice given by ESMA to the Commission should not take the form of a legal text. However, ESMA should provide the Commission with an "articulated" text which means a clear and structured text, accompanied by sufficient and detailed explanations for the advice given, and which is presented in an easily understandable language respecting current terminology in the Union.
- ESMA should address to the Commission any question they might have concerning the clarification on the text of the amended Regulation, which they should consider of relevance to the preparation of its technical advice.

2. Procedure

The Commission would like to request the technical advice of ESMA on the content of the possible delegated acts to be adopted pursuant to the amended Regulation.

The mandate follows the ESMA Regulation, the 290 Communication and the Framework Agreement.

The Commission reserves the right to revise and/or supplement this formal mandate. The technical advice received on the basis of this mandate should not prejudice the Commission's final decision.

In accordance with the Declaration 39 on Article 290 TFEU, annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December 2007, and in accordance with the established practice, the Commission will continue to consult experts appointed by the Member States in the preparation of the delegated acts relating to the CRA Regulation.

Moreover, in accordance with point 15 of the Framework Agreement, the Commission will provide full information and documentation on its meetings with national experts within the

framework of its work on the preparation and implementation of Union legislation, including soft law and delegated acts. Upon request by the Parliament, the Commission may also invite Parliament's experts to attend those meetings.

The Commission has duly informed the European Parliament and the Council about this mandate. As soon as the Commission adopts possible delegated acts, it will notify them simultaneously to the European Parliament and the Council.

3. Technical advice on a Regulation on fees (Article 19(2) of the amended Regulation)

The amended CRA Regulation requires the Commission to adopt a Regulation on fees determining the type of fees and the matters for which fees are due, the amount of the fees and the way in which fees are to be paid. The amended Regulation further determines that the fees collected from CRAs shall fully cover ESMA's expenditure necessary for the registration and supervision of CRAs. The amount of the fees charged to individual CRAs shall be proportionate to the turnover of the credit rating agencies concerned.

ESMA is invited to deliver its advice on the following aspects of a Regulation on fees:

- ESMA is invited to reflect on the type of fees that could be levied. Fees could be provided for specific supervisory actions (e.g. registration fees) or a general (annual) flat fee could be levied which would cover all supervisory activity for one year. Also, a mixed system (fees for individual supervisory actions complemented by a general flat fee to cover the remaining expenditure) could be considered.

- In case ESMA suggests fees for specific supervisory actions, ESMA should draw up a list of supervisory actions with the corresponding amounts of fees. According to Article 19 of the amended Regulation the amount of the fee shall be proportionate to the turnover of the credit rating agency and at the same time shall cover all the administrative costs. The amount of the fees for a supervisory action should therefore reflect the expected expenditure of ESMA in providing a specific supervisory action, considering that the expenditure would normally increase with the size of the supervised entity as indicated by its turnover. The amount of the fees to be charged for a specific supervisory action should be precise, i.e. ESMA should not be granted discretion in setting the amount of the fees.

- In case ESMA suggests annual flat fees, ESMA should indicate how the flat fee should be calculated, i.e. how its expenditure necessary for the registration and supervision of CRAs should be distributed to the individual supervised credit rating agencies. Again, the flat fee would have to be proportionate to the turnover of the credit rating agencies concerned and all fees together would have to cover the total of ESMA's expenditure related to CRA supervision.

- ESMA should suggest the timing and appropriate modalities of the payment of the fees⁶. It has to be ensured that ESMA always disposes of the necessary resources to finance its CRA related activities. This could e.g. be achieved by requiring the supervised CRAs to pay the expected fees upfront, drawing up an account at the end of the year.

⁶ Consideration should be taken of relevant provisions in ESMA's Financial Regulation (see Articles 55 ff, 59 of the draft Financial Regulation)

- According to Article 19 (2) of the amended Regulation ESMA's expenditure on the registration and supervision of CRAs shall be fully covered by fees levied from CRAs. This should apply from 1 July 2011, when ESMA will take over the supervision of CRAs according to Article 40a (1) of the amended Regulation. In the transition year of 2011 ESMA's expenditure on CRA's has been prefunded by Member States and Community contributions according to the ratio foreseen in the ESMA Regulation (40 % Community and 60 % Member States contributions). The costs for CRA supervision from July 2011 should therefore be claimed back from the CRA industry on the basis of the Regulation on fees. ESMA should suggest modalities for the recovery of these costs from CRAs.

- The amended Regulation specifies that the fees levied from credit rating agencies should cover ESMA's expenditure for reimbursing any costs that competent authorities may incur carrying out work under this Regulation, in particular as a result of a delegation of task according to Article 30 of the amended Regulation. This provision clarifies that only ESMA, but not the competent authorities should be entitled to claim fees directly from the credit rating agencies. However, the competent authorities that are delegated specific supervisory tasks may claim reimbursement from ESMA on the basis of the Regulation on fees. ESMA is invited to suggest a method for the calculation of the amount that competent authorities may claim from ESMA. The amount should depend on the scope and complexity of the task to be delegated and should be consistent with any specific supervisory fee that ESMA can claim from the credit rating agency for undertaking a supervisory action.

4. Indicative timetable

This mandate takes into consideration that ESMA needs enough time to prepare its technical advice and that the Commission needs to adopt the delegated acts according to Article 290 of the TFEU. The powers of the Commission to adopt delegated acts are subject to Articles 38a-c of the amended Regulation.

The regulation on fees should enter into force at the latest in November 2011, as it will be the legal basis on which ESMA will charge fees from CRAs to cover its CRA related expenditure as from January 2012. This timeline takes into account that ESMA needs some time to proceed with fee claims against credit rating agencies ensuring that funds are available to cover ESMA's CRA related expenditure as from 1 January 2012. The timeline has also to take into account that after adoption of the delegated act by the Commission (foreseen in July 2011), the European Parliament and the Council may according to Article 38c (1) of the amended Regulation object to the delegated act within a period of three months, i.e. until October 2011⁷. Only on the expiration of this period with neither the European Parliament nor the Council having objected or, alternatively, when the European Parliament and the Council have both informed the Commission of their intention not to raise objections, the delegated act can be published in the Official Journal of the European Union and enter into force.

Therefore it is of utmost importance to start working on this issue as soon as possible.

The deadline set to ESMA to deliver the technical advice is **13 May 2011**. The establishment of the deadline is based on the following indicative timetable:

⁷ At the initiative of the European Parliament or the Council that period shall be extended by three months.

Deadline	Action
February 2011	Submission by the Commission of the formal mandate to ESMA.
April 2011 (tbc)	Expected entry into force of the amended Regulation (20 days after publication in the Official Journal of the European Union).
13 May 2011	ESMA provides its technical advice.
May – July 2011	Preparation of the delegated act: In the preparation of the delegated act, the Commission will consult with experts appointed by the Member States within the European Securities Committee ⁸ . The Commission will provide the European Parliament with full information and documentation on those meetings.
July 2011	Adoption of the delegated act: Formal adoption by the Commission of the delegated act and notification to the European Parliament and the Council.
October 2011	End of the regular objection period of three months for the European Parliament and the Council according to Article 38c (1) of the amended Regulation.
November 2011 (indicative)	Publication of the delegated act in the Official Journal and entry into force.

⁸ See Declaration 39 on Article 290 TFEU, annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December 2007