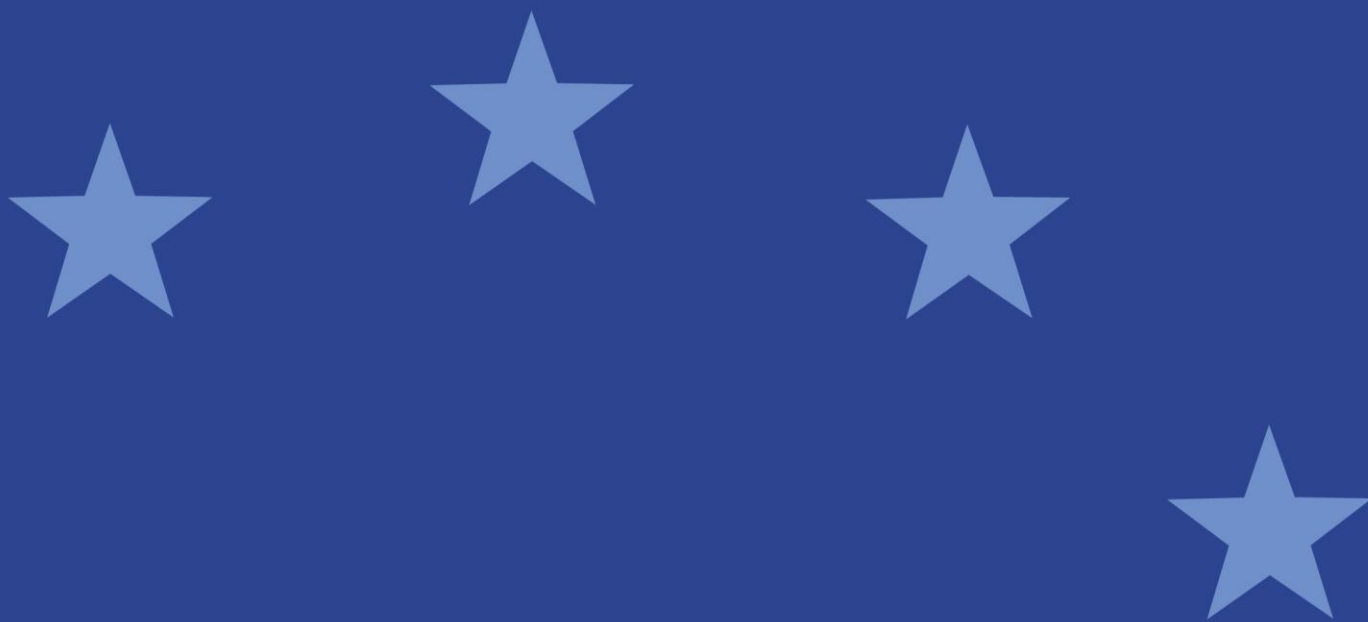




European Securities and
Markets Authority

Consultation paper

Guidelines and recommendations on the scope of the CRA Regulation



Responding to this consultation paper

ESMA invites comments on all matters of this consultation paper and, in particular, on the specific questions listed in Annex I. Comments are most helpful if they:

- indicate the number of the question to which the comments relates;
- respond to the question stated;
- contain a clear rationale, including on any related costs and benefits; and
- describe any alternative ESMA should consider.

Comments should reach us by 20 February 2013.

All contributions should be submitted online at www.esma.europa.eu under the heading “Your input/Consultations”.

Publication of responses

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

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading ‘Disclaimer’.

Who should read this paper?

This consultation paper should be read by credit rating agencies (as defined in Article 3(1)(b) of the CRA Regulation), credit scoring companies, non-registered credit rating agencies, competent authorities, and consumer groups.

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Acronyms

NCA_s National Competent Authorities

SCA Sectoral Competent Authorities



Definitions

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

National Competent Authorities: Authorities as defined in the CRA Regulation, Article 3(1)(p).

Sectoral Competent Authorities: Authorities as defined in the CRA Regulation, Article 3(1)(r).

1. Overview

Reasons for publication

1. The CRA Regulation provides that a credit rating agency established in the EU must be registered under the terms established by the same Regulation in order to conduct credit rating activities and distribute credit ratings to the public in the Union for regulatory and non-regulatory purposes.
2. Credit ratings issued by credit rating agencies established in a third country and certified in accordance with the CRA Regulation may also be used for regulatory purposes. The certification mechanism allows only the use for regulatory purposes in the Union of ratings relating to entities or financial instruments established or issued in third countries.
3. On the other hand, the CRA Regulation does not apply, among other things, to credit scores, credit scoring systems or similar assessments related to obligations arising from consumer, commercial or industrial relationships, to private ratings produced pursuant to an individual order and provided exclusively to the person who placed the order and which are not intended for public disclosure or distribution by subscription, and to credit ratings produced by export credit agencies.
4. However, the Regulation does not currently specify how credit scores should be defined and does not provide any specific requirements for credit scoring firms and non-registered CRAs in order to allow for a clear and prominent disclosure that those scores or ratings mentioned in the previous paragraph are not issued in accordance with the CRA Regulation.
5. Furthermore, the CRA Regulation does not provide a specific regime for branches established outside the Union by registered credit rating agencies.
6. On the basis of the experience acquired so far through the registration process and the enforcement of the perimeter of the CRA Regulation, ESMA sees merit in clarifying the interpretation of the scope of the Regulation.

Contents

7. Section II. Obligation to register. A credit rating agency established in the EU must be registered under the CRA Regulation in order to conduct rating activities according to Article 2(1). Certification is only allowed with regards to ratings relating to entities established or financial instruments issued in third countries.
8. Section III. Credit rating activities and exemptions from registration. Credit ratings, as defined in the CRA Regulation, should include not just quantitative analysis but also sufficient qualitative analysis,

according to the rating methodology established by the credit rating agency. A measure of creditworthiness derived from summarising and expressing data based only on a pre-set statistical system or model, without any additional substantial rating-specific analytical input from a rating analyst, should not be considered as a credit rating.

9. Section IV. Private ratings. Private ratings respond to an individual, specific and documented order placed by a determined person; ratings distributed to a list of subscribers do not fall within the definition of private rating and are, therefore, subject to the CRA Regulation.
10. Section V. Establishment of branches in third countries. Credit rating agencies' important operational functions should not be operated through branches established outside the Union.
11. Section VI. Specific disclosure recommendations for credit scoring firms and CRAs established in third countries. In order to guarantee a high level of investor protection, ESMA recommends that credit scoring firms that distribute credit scores to the public in the Union provide clear and prominent disclosure that those scores are not credit ratings issued in accordance with the CRA Regulation.
12. Section VII. Enforcement of the scope of the CRA Regulation. ESMA will take action in accordance with Article 24(1), based upon appropriate prior investigation pursuant to Articles 23(b) to 23(d), against any credit rating agencies issuing, endorsing, or distributing credit ratings to the public or by subscription in the Union without being registered, or certified as appropriate, under the CRA Regulation. NCAs and SCAs shall inform ESMA pursuant to Articles 26 and 27 of the CRA Regulation for the purposes of enforcing the scope of the Regulation.

Next steps

13. ESMA will consider the responses it receives to this consultation paper in Q2 2013 and expects to publish a final report, and final Guidelines and recommendations, by Q3 2013.
14. These Guidelines and recommendations are based solely on the requirements established by the current CRA Regulation. The potential impact of proposed amendments to the CRA Regulation¹ falls outside of the scope of this exercise. However, ESMA will consider whether these Guidelines and recommendations will need to be revised once the amending Regulation has been adopted.

¹ Available at: http://ec.europa.eu/internal_market/securities/agencies/index_en.htm

2. Background

15. These Guidelines and recommendations constitute a follow-up to the initial communication on the scope of the Regulation (EC) No 1060/2009 of 16 September 2009, published in the Frequently Asked Questions issued by ESMA on 4 June 2010.²
16. Since then, the CRA Regulation has been amended to a significant extent by the Regulation (EU) No 513/2011 of 11 May 2011. Moreover, ESMA has received the input from NCAs concerning several entities that might potentially be considered as credit rating agencies. ESMA has contacted such entities to determine whether they are conducting activities within the scope of the CRA Regulation.
17. Given such legislative and supervisory developments, ESMA deems that updated clarifications on the scope of the CRA Regulation should be presented through Guidelines and recommendations. In this consultation paper ESMA invites comments that will be considered before adopting the final version of the Guidelines and recommendations.

² Available at: http://www.esma.europa.eu/system/files/10_521.pdf

3. Obligation to register

Overview

18. A credit rating agency must be registered under the CRA Regulation in order to conduct rating activities if it is a legal person established in the EU. In particular, Articles 2(1) and 14(1) of the CRA Regulation state that CRAs established in the Union shall apply for registration to the extent to which they intend to disclose their ratings to the public - or to distribute them by subscription - and independent of whether those ratings are meant to be used for regulatory purposes.
19. The obligation to register under the CRA Regulation applies to CRAs defined as legal persons established in the Union, whose occupation includes the issuing of credit ratings on a professional basis (Article 3 (b)).
20. The Regulation establishes a number of substantive and procedural requirements that apply to registered or certified CRAs. The physical presence in the EU is a key requirement to ensure effective supervision by ESMA, whose powers can be directly and immediately exercised throughout the Union.

Practical example

- 1) A CRA established in a third country conducts credit rating activities in Europe through a subsidiary (a legal entity established in the EU but not registered by ESMA). The analysts of the third-country CRA, which distributes ratings in the EU, have labour arrangements with the EU subsidiary.

Conclusion: the subsidiary established in the EU conducts credit rating activities in the EU, and is therefore required to stop issuing credit ratings and to apply for registration under the CRA Regulation.

21. Credit ratings issued by credit rating agencies established in third countries can be endorsed by a credit rating agency registered in the EU under the conditions set out in Art. 4 of the CRA Regulation.
22. In parallel, the certification mechanism provided in Article 5 allows credit rating agencies established in third countries to distribute certain types of their ratings in the Union for regulatory purposes without a physical presence in the EU. Certification can only be granted to credit rating agencies that do not have systemic importance for the stability or the integrity of the financial markets of one or more Member States.
23. A credit rating agency established in a third country and certified in accordance with Article 5 of the CRA Regulation can conduct rating activities in the Union for regulatory purposes only with respect to

credit ratings relating to entities established or financial instruments issued in third countries. Therefore, ratings issued by certified credit rating agencies related to entities established or financial instruments issued in the EU may not be used for regulatory purposes.

24. Credit ratings issued outside the Union by a credit rating agency of systemic importance to the financial markets of one or more Member States can only be used for regulatory purposes in the EU when fulfilling the condition for endorsement set out in Article 4(3) of the CRA Regulation, as clarified in the ESMA Guidelines of 18 May 2011.³ As a consequence, when such credit rating agencies intend to conduct credit rating activities in the Union and distribute their ratings to the public, they shall always establish legal persons and obtain registration in the Union under the CRA Regulation.

Proposed Guidelines

25. Credit rating agencies without a physical presence in the EU and fulfilling the prerequisites of Article 5 shall obtain certification from ESMA before distributing credit ratings for regulatory purposes in the EU.
26. Credit rating agencies that are carrying out credit rating activities in the EU without prior registration are operating illegally. Any credit rating agency that carries out credit rating activities in the EU shall immediately apply for registration by ESMA. Entities must not issue credit ratings until they are registered as CRAs. Such obligations also apply to legal entities established in the EU which employ rating analysts providing rating services on behalf of a third-country entity.
27. Only a legal person can apply for registration. A natural person cannot apply for registration.
28. ESMA shall take action according to Article 24 of the CRA Regulation against credit rating agencies that operate illegally without registration or, where appropriate, certification in the Union and impose a fine pursuant to Article 36a and Annex III.54 of the CRA Regulation

Questions

- Q1. **Do you agree with the approach set out above on the obligation to register?**
- Q2. **What may be alternative/additional criteria to require registration and certification?**

³ Available at : http://www.esma.europa.eu/system/files/ESMA_2011_139.pdf

4. Credit rating activities and exemptions from registration

Overview

29. The Regulation defines a credit rating as “an opinion regarding the creditworthiness of an entity [...] issued using an established and defined ranking system of rating categories (Article 3(1)(a)).” As a consequence, any other type of analysis or recommendation, including the instruments described in Article 3(2) of the Regulation, which differs from an opinion regarding the creditworthiness of an entity, are not credit ratings within the meaning of the CRA Regulation. This includes, for instance, opinions issued in respect of instruments that are predominantly exposed to other forms of risks (i.e. market or business risk) different from credit or default risk, such as shares of equity or, in the vast generality of the cases, units of collective investment schemes.
30. Moreover, the CRA Regulation does not apply, among other things, to credit scores, credit scoring systems or similar assessments related to obligations arising from consumer, commercial or industrial relationships.
31. The issuing of credit ratings under the CRA Regulation requires the assessment of the creditworthiness of entities or debt or financial instruments. This process must be the result of the contribution by rating analysts in terms of professional knowledge, expertise, and analytical skills. Analysts’ judgement can regard both quantitative and qualitative information. However, expert judgement has a key role in the treatment of qualitative information (e.g. quality of management, assessment of business model, political environment, and so on) and in the final assessment of the overall outcome of the credit analysis.
32. In some cases, CRAs feed qualitative information through quantitative models, by transforming qualitative inputs into quantitative data suitable to be processed by the algorithms included in these models. This task is carried out by the analysts using their skills and judgement and, as such, must be deemed as part of the qualitative overlay.
33. Qualitative input from credit analysts, however, is a complement and not a substitute for the use of techniques that ensure consistent treatment of quantitative data. A rigorous, continuous and systematic rating methodology may therefore involve the use of pre-set analytical instruments, such as scorecards, models or other statistical tools, along with a clear indication of how, when and according to which criteria analysts’ judgment is to be exercised.
34. Similarly to credit scores, credit ratings that are prepared on grounds of existing ratings via automatic (averaging) techniques, do not fall within the scope of the Regulation. The CRA Regulation requires that activities carried out by registered CRAs have to involve assessments of information, beyond col-

lection and verification of relevant data points, in respect of the production of individual credit scores or *average* ratings.

Practical examples

- 2) An entity uses a methodology which includes both quantitative and qualitative information, including mechanisms for stabilizing the outcome of the risk analysis, and publishes its assessments with reference to a discrete scale encompassing symbols commonly used for credit ratings as defined in Article 3(1) of the CRA Regulation.

Conclusion: this entity must apply for registration under the CRA Regulation.

- 3) An entity while making large use of quantitative models, feeds substantive qualitative information through these models, by transforming qualitative inputs into quantitative data suitable to be processed by the algorithms in the (econometrics) models. Transformation of qualitative information into numeric input is carried out by the analysts, on grounds of their expert judgement, which is anyway bound by strict guidance provided by the company in the form of specific criteria.

Conclusion: the entity must apply for registration under the CRA Regulation.

- 4) An entity provides an average of ratings issued by several rating agencies rounded down to the lower category if the average is between two rating categories. It weights the ratings contributed by each rating agency evenly when generating the service it provides to its subscribers.

Conclusion: the entity does not fall within the scope of the CRA Regulation.

Proposed Guidelines

35. Credit ratings, as defined in the CRA Regulation, should include not just quantitative analysis but also sufficient qualitative analysis, according to the rating methodology established by the credit rating agency. A measure of creditworthiness derived from summarising and expressing data based only on a pre-set statistical system or model, without any additional substantial rating-specific analytical input from a rating analyst, should not be considered as a credit rating.

Questions

- Q3. **Do you agree with the explanation of credit ratings provided in this document?**

- Q4. Do you believe that the intervention of rating analysts in the assessment of the relevant information is the key element to distinguish credit ratings from credit scorings?**

Private ratings

Overview

36. The CRA Regulation does not apply, among others, to “private ratings produced pursuant to an individual order and provided exclusively to the person who placed the order and which are not intended for public disclosure or distribution by subscription” (Article 2(2)(a)). Therefore, private ratings cannot be used for regulatory purposes in accordance with Article 4(1) of the CRA Regulation.
37. A legal entity that exclusively issues private credit ratings does not have to register and is not subject to supervision. Furthermore, when issuing private ratings registered CRAs do not have to comply with the requirements of the CRA Regulation.
38. Article 2(2) of the CRA Regulation does not imply that any transmission of the rating to a third party by the person that ordered it would exclude its private character. Therefore, the recipient of a private rating is allowed to share the rating with a limited number of third parties and on a strictly confidential basis to ensure that the private rating is not disclosed further.

Practical example

- 5) The recipient of a private rating shares his rating with his bank, when applying for a loan.

Conclusion. This rating should be considered as a private rating.

39. The agency that issues a private rating should inform the recipient of the restricted private use he is only allowed to make of the rating, that he may only transmit the rating to a limited number of third parties which should be bound to strict confidentiality either by contractual obligations or by the relevant national law and that the private rating cannot be used for regulatory purposes.

Proposed Guidelines

40. A rating that responds to an individual order placed by a person is a private rating falling outside the definition of a “private credit rating” in Article 2(2)(a) of the CRA Regulation.
41. A rating which is provided to different persons belonging to a list of subscribers, does not fall within the definition of “private credit rating” in Article 2(2) (a) of the CRA Regulation.

42. In accordance with Article 2(2)(a), credit rating agencies should ensure that the agreements for the issuance of private ratings cover the duty of confidentiality and limitations on the distribution of the ratings. In issuing private ratings credit rating agencies should inquire whether the person who placed the order, as recipient of the private rating, has any intention to use the rating in a way that would bring it into the public domain or to use it for regulatory purposes. Where the credit rating agencies can reasonably conclude that a private rating is to be disclosed to the public, it shall refrain from issuing that rating.

Question

Q5. Do you agree with the explanation of private ratings provided?

5. Establishment of branches outside the Union by registered credit rating agencies

Overview

43. The CRA Regulation does not explicitly set out rules on the establishment of branches of EU credit rating agencies outside the Union, other than a material notification requirement in Article 14(3). However, the establishment of branches in third countries may raise concerns for the supervision by ESMA of the activities performed through those branches.
44. Credit rating agencies are responsible for the ratings developed in branches located outside the Union. In this respect, ESMA expects that credit rating agencies maintain all the appropriate records related to the rating activity conducted in those branches established outside the Union (as required by the CRA Regulation) and preserve a correct and proportionate balance between the ratings produced in their EU offices and those issued in branches located outside the Union. Credit rating agencies should demonstrate that there is an objective reason for credit ratings to be issued in branches established outside the Union.
45. The establishment of branches in third countries should not impair the ability of the credit rating agencies to meet the requirements of the CRA Regulation, and in particular to allow an effective supervision by ESMA of all their relevant operations, rating activities as well as internal controls (compliance, internal review, internal audit, risk assessment, and so on), that are performed by the credit rating agency. In this respect, ESMA will assess the need to enter into cooperation arrangements with the local competent regulators to ensure adequate supervision of branches located outside the Union.
46. A credit rating agency that intends to carry out entirely (or prevalently) its rating activities through branches established in third countries can create serious impediments to the effective exercise of supervision by ESMA. In such cases, the information retained in the EU offices of the credit rating agency, that can be easily and timely reached by ESMA, might turn out to be limited (“empty shells”), whereas the actual rating activities are mainly operated in overseas branches.
47. Similarly, important operational functions, as set out in Art. 9 of the Regulation, should not be based or primarily operated in offices established in third-countries with no (or very limited) involvement of EU-based managers, systems or procedures of the credit rating agency.
48. Important operational functions such as those mentioned above include units or divisions in charge of elaboration and issuance of credit ratings, credit analysis, rating methodology development and review, compliance, internal quality control, data storage/record keeping and systems maintenance or

support. In some cases however, the definition of important operational functions may require case-by-case consideration. As regards the compliance function, some level of relevant staff should be present in the branches established outside the European Union.

49. Credit rating agencies should adopt internal arrangements so as to allow ESMA to acquire all relevant documents and records regarding the activities carried out in branches outside the EU in the course of inspections or investigations of the CRA. For this purposes, credit rating agencies are expected to cooperate with ESMA in case of inspections or investigations, including on-site visits, regarding ratings or rating activities carried in non-EU branches.
50. Section A, Annex I, of the CRA Regulation requires credit rating agencies to adopt sound administrative procedures, which, in case of branches established outside the Union, would have to entail ad-hoc measures to monitor and control the activities performed in those premises.
51. Credit rating agencies should not establish branches outside the EU for the purpose of circumventing the requirements established by the CRA Regulation, including those set out in Article 4(3). To this extent, rating activities, as well as other important operational functions, should not be entirely (or prevalently) conducted in branches outside the EU where ESMA cannot exercise effective supervision, directly or in cooperation with national regulators.

Proposed Guidelines

52. Since branches do not have a separate legal personality from their parent, credit ratings issued in branches established outside the Union are deemed to be issued by their EU parent. Therefore, infringements by the branches of the CRA Regulation are attributable to the parent CRA which shall be the object of ESMA's enforcement actions.
53. ESMA would risk being prevented from performing its supervisory tasks if the important operational functions of credit rating agencies were based and primarily operated outside the Union. Therefore, ESMA would take action according to Article 24, 36a, 36b, namely due to infringements by the CRA of Annex III part II points 2, 4, 5, 6, 7 and 8 of the CRA Regulation.
54. Credit rating agencies shall not establish branches in third countries to perform activities that are subject to supervision by ESMA if this prevents ESMA from conducting supervisory tasks in relation to those branches as set out in articles 23b to 23d of the Regulation, including the ability to carry out on-site inspections and investigations. In this respect:
 - a) credit rating agencies should cooperate with ESMA in case of inspections or investigations, including on-site visits, regarding ratings or rating activities carried out in non-EU branches;

- b) ESMA will assess the need to enter into cooperation arrangements with the local competent regulators to ensure the adequate supervision of branches located outside the Union;
- c) prior to establishing branches in third countries, credit rating agencies should ensure that those branches will comply immediately with any request set forth by the officials of ESMA in the exercise of powers pursuant to Articles 23b to 23d of the CRA Regulation, including granting of access to premises, systems and resources in the case of on-site inspections and investigations.

Questions

- Q6. **Do you agree with the approach taken in the text above regarding the establishment of branches of registered credit rating agencies outside the Union?**
- Q7. **Do you agree that credit rating agencies should demonstrate that there is an objective reason to conduct certain credit rating activities in branches established outside the Union?**
- Q8. **Do you agree that ESMA's capacity to deliver effective supervision would be impaired where credit rating agencies conducted entirely or prevalently important operational functions, and in particular credit rating activities, in branches outside the EU?**

6. Specific disclosure best practices

Overview

55. ESMA supervises credit rating activities in order to ensure, among other objectives in Article 1 of the CRA Regulation, a high level of consumer and investor protection.
56. Article 3(1)(a) of the Regulation requires credit ratings to be issued according to an “established and defined ranking system of rating categories”. This requirement serves a general purpose of investor protection in the EU, which may be put at risk when also credit scoring firms present their scores or ratings using categories similar to those used by registered or certified CRAs.
57. The Regulation establishes clear obligations concerning the presentation of credit ratings and, in particular, regarding whether the rating is issued by a registered CRA, endorsed in accordance with Article 4(3), or prepared by a certified credit rating agency established in a third country where a regime equivalent to the CRA Regulation is in place.
58. Furthermore, in order to achieve and enhance a high level of financial consumer protection, as stated in the CRA Regulation, ESMA publishes on its webpage an updated list of the registered credit rating agencies to give investors the opportunity to have complete disclosure of and knowledge about the names of all the CRAs registered under the Regulation.
59. ESMA is of the view that financial consumer protection in the Union should be ensured with respect to the organization and performance of ratings activities. ESMA recommends that credit scoring firms or export credit agencies that wish to address their products to the EU public by any means, should provide appropriate disclosure explaining that those scores or ratings are not prepared in accordance with the CRA Regulation and, consequently, cannot be used for regulatory purposes in the EU. ESMA recommends that this applies also when credit scores or ratings are distributed to the public in the EU, via publication or subscription to services, in light of agreements with third party independent or affiliated companies.

Practical example

- 6) A credit scoring firm which is not registered under the CRA Regulation and does not provide any credit rating activity, uses the word “rating” and makes reference to a discrete scale encompassing symbols.

Conclusion: the credit scoring firm should remove any reference to “ratings” and clarify that the symbols do not constitute credit ratings, to avoid misinterpretation of the service provided through the webpage.

Proposed best practice

60. ESMA recommends as a best practice that credit scoring firms that distribute credit scores to the public in the Union provide clear and prominent disclosure that those scores are not credit ratings issued in accordance with the CRA Regulation. ESMA recommends that this disclosure should be provided also by export credit agencies that act under Article 2(2)(c) of the Regulation.
61. ESMA recommends as a best practice that, should credit scoring firms and export credit agencies decide to publish such information, they should retain full responsibility for the disclosure indicated in the previous paragraphs when their credit scores or ratings are distributed to the public in the Union via agreement with third parties.
62. Credit scores or ratings are distributed to the public in the EU when they are disclosed to an undetermined or undeterminable generality of individuals domiciled in the EU. Credit scores or ratings are also distributed to the public when they are issued through a website registered with a domain corresponding to one of the Member States of the EU.

Questions

- Q9. **Do you agree with the disclosure best practices indicated above and with their remit?**
- Q10. **Do you agree that credit scoring firms and export credit agencies that distribute their products to the public in EU should consider ESMA’s suggested disclosures that such scores or ratings are not issued in accordance with the CRA Regulation?**
- Q11. **Do you agree with ESMA recommendations that the credit scoring firms and export credit agencies retain full responsibility for the disclosure indicated above when their scores or ratings are distributed to the public in the EU via agreement with third parties?**

7. Enforcement of the scope of the CRA Regulation

Overview

63. NCAs and SCAs are well positioned to identify in their national markets the entities whose activity is potentially subject to the CRA Regulation.
64. The CRA Regulation has entrusted ESMA as the sole supervisory authority on credit rating agencies in the Union. As a consequence, when a NCA or a SCA is contacted by a market participant in relation to subjects that pertain to the application of the CRA Regulation, in the first place registration or certification, the authority shall immediately refer that market participant to ESMA and provide all relevant information to ESMA in the spirit of cooperation as set out in Article 2(4) of Regulation (EU) No 1095/2010.
65. ESMA, NCAs, and SCAs are required, without undue delay, to supply each other with the information required for the purposes of carrying out their duties under the Regulation and under the relevant sectorial legislation (Articles 26, 27, and 31 of the CRA Regulation).
66. All the information that is acquired by or exchanged between ESMA, the competent authorities, the sectoral competent authorities or other authorities and bodies referred to in Article 27(2) shall be considered confidential except where ESMA or the competent authority or other authority or body concerned states at the time of the communication that such information may be disclosed or where such disclosure is necessary for legal proceedings (Article 32(2)).
67. Where NCAs and SCAs find that a credit rating agency might be issuing and distributing credit ratings to the public or by subscription in the EU without being registered, those NCAs and SCAs should immediately give notice of such circumstance to ESMA and provide all the relevant information in their possession, in accordance with Article 31 of the CRA Regulation.
68. As ESMA shall take action in accordance with Article 24(1) of the CRA Regulation, upon appropriate prior investigation pursuant to Articles 23(b) to 23(d), against any credit rating agencies established in the Union issuing and distributing credit ratings to the public or by subscription without being registered under the CRA Regulation, NCAs and SCAs shall inform ESMA pursuant to Articles 26, 27, and 31 of the CRA Regulation for the purposes of enforcing the scope of the CRA Regulation.

Proposed Guidelines

69. ESMA shall impose periodic penalty payments in order to compel the credit rating agency to put an end to the infringement of issuing credit ratings without being registered by ESMA, and impose fines where appropriate, in accordance with Articles 36(a) and 36(b) of the CRA Regulation. This applies al-



so to registered credit rating agencies that create impediments to the effective supervision from ESMA by carrying out entirely (or prevalently) important operational functions in branches outside the EU.

70. Where a NCA or a SCA receives an application, request for information, or any other form of inquiry concerning the CRA Regulation, including on registration or certification, that authority should immediately notify ESMA and refer the financial market participant that has submitted the request to ESMA as the sole competent supervisory authority in the Union.

Questions

- Q12. Do you agree that ESMA should take action to prevent any entity from abusively distributing credit ratings in the EU?**

Annex I: List of consultation questions

- Q1. Do you agree with the approach set out above on the obligation to register?
- Q2. What may be alternative/additional criteria to require registration and certification?
- Q3. Do you agree with the explanation of credit ratings provided in this document?
- Q4. Do you believe that the intervention of rating analysts in the assessment of the relevant information is the key element to distinguish credit ratings from credit scorings?
- Q5. Do you agree with the explanation of private ratings provided?
- Q6. Do you agree with the approach taken in the text above regarding the establishment of branches of registered credit rating agencies outside the Union?
- Q7. Do you agree that credit rating agencies should demonstrate that there is an objective reason to conduct certain credit rating activities in branches established outside the Union?
- Q8. Do you agree that ESMA's capacity to deliver effective would be impaired where credit rating agencies conducted entirely or prevalently important operational functions, and in particular credit rating activities, in branches outside the EU?
- Q9. Do you agree with the disclosure recommendations indicated above and with their remit?
- Q10. Do you agree that credit scoring firms and export credit agencies that distribute their products to the public in EU should consider ESMA's suggested disclosures that such scores or ratings are not issued in accordance with the CRA Regulation?
- Q11. Do you agree with ESMA recommendation that the credit scoring firms and export credit agencies retain full responsibility for the disclosure indicated above when their scores or ratings are distributed to the public in the EU via agreement with third parties?
- Q12. Do you agree that ESMA should take action to prevent any entity from abusively distributing credit ratings in the EU?

Annex II: Draft Guidelines and recommendations

I. Scope

Who?

1. These Guidelines and recommendations apply to:
 - a. credit rating agencies (as defined in the Article 3(1)(a) of the CRA Regulation);
 - b. NCAs and SCAs.

When?

2. These Guidelines and recommendation apply upon adoption by the Board of Supervisors. These Guidelines and recommendations will be published in all EU official languages

II. Definitions

3. CRA Regulation: Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies amended by Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011
4. National Competent Authorities: Authorities as defined in the CRA Regulation, Art. 3(1)(p).
5. Sectoral Competent Authorities: Authorities as defined in the CRA Regulation, Art. 3(1)(r).

III. Purpose

6. The purpose of these guidelines and recommendations is to provide a clarification of the scope of the CRA Regulation, in particular concerning the following specific profiles:
 - a. obligation to register;
 - b. credit rating activities and exemptions from registration;
 - c. private ratings;
 - d. establishment of branches in third countries;
 - e. specific disclosure recommendations for credit scoring firms and CRAs established in third countries;
 - f. enforcement of the scope of the CRA Regulation and Cooperation with National Competent Authorities.

IV. Compliance and reporting obligations

Status of the Guidelines and recommendations

7. This document contains guidelines and recommendations issued under Article 16 of the ESMA Regulation. In accordance with Article 16(3) of the ESMA Regulation competent authorities and financial market participants must make every effort to comply with the guidelines and recommendations.
8. Competent authorities to whom the guidelines and recommendations apply should comply by incorporating them into their supervisory practices, including where particular guidelines within the document are directed primarily at financial market participants.
9. As regards all the other chapters of these Guidelines and recommendations, NCAs and financial market participants are required to respect the provisions of the CRA Regulation, while ESMA has the duty to ensure the application of the same Regulation.

Reporting requirements

10. As regards Ch. VIII (*Specific disclosure recommendations*), competent authorities to which these guidelines apply must notify ESMA whether they comply or intend to comply with the recommendations, with reasons for non-compliance, within two months of the date of publication by ESMA to info@esma.europa.eu. In the absence of a response by this deadline, competent authorities will be considered as non-compliant. A template for notifications is available from the ESMA website.
11. Financial market participants are required to report whether they comply or intend to comply with Ch. VIII of these Guidelines and recommendations within two months of the date of publication by ESMA to info@esma.europa.eu. A template for notifications is available from the ESMA website.

V. Obligation to register

12. Credit rating agencies without a physical presence in the EU and fulfilling the prerequisites of Article 5 shall obtain certification from ESMA before distributing credit ratings for regulatory purposes in the EU.
13. Credit rating agencies that are carrying out credit rating activities in the EU without prior registration are operating illegally. Any credit rating agency that carries out credit rating activities shall immediately apply for registration by ESMA. Entities must not issue credit ratings until they are registered as CRAs. Such obligations also apply to legal entities established in the EU which employ rating analysts providing rating services to a third-country entity.
14. Only a legal person can apply for registration. A natural person cannot apply for registration.

15. ESMA shall take action according to Article 24 of the CRA Regulation against credit rating agencies that operate illegally without registration or, where appropriate, certification in the Union and impose a fine pursuant to Article 36a and Annex III.54 of the CRA Regulation.

VI. Credit rating activities and exemptions from registration

16. Credit ratings, as defined in the CRA Regulation, should include not just quantitative analysis but also sufficient qualitative analysis, according to the rating methodology established by the credit rating agency. A measure of creditworthiness derived from summarising and expressing data based only on a pre-set statistical system or model, without any additional substantial rating-specific analytical input from a rating analyst, should not be considered as a credit rating.
17. A rating that responds to an individual order placed by a person is a private rating falling outside the definition of a “private credit rating” in Article 2(2)(a) of the CRA Regulation
18. A rating which is provided to different persons belonging to a list of subscribers, does not fall within the definition of “private rating” in Article 2(2)(a) of the CRA Regulation.
19. In accordance with Article 2(2)(a), credit rating agencies should ensure that the agreements for the issuance of private ratings cover the duty of confidentiality and limitations on the distribution of the ratings. In issuing private ratings credit rating agencies should inquire whether the person who placed the order, as recipient of the private rating, has any intention to use the rating in a way that would bring it into the public domain or to use it for regulatory purposes. Where the credit rating agencies can reasonably conclude that a private rating is to be disclosed to the public, they shall refrain from issuing that rating.

VII. Establishment of branches outside the Union by registered credit rating agencies

20. Since branches do not have a separate legal personality from their parent, credit ratings issued in branches established outside the Union are deemed to be issued by their EU parent. Therefore, infringements by the branches of the CRA Regulation are attributable to the parent CRA which shall be the object of ESMA’s enforcement actions.
21. ESMA would risk being prevented from performing its supervisory tasks if the important operational functions of credit rating agencies were based and primarily operated outside the Union. Therefore, ESMA would take action according to Article 24, 36a, 36b, namely due to infringements by the CRA of Annex III part II points 2, 4, 5, 6, 7 and 8 of the CRA Regulation.
22. Credit rating agencies shall not establish branches in third countries to perform activities that are subject to supervision by ESMA if this prevents ESMA from conducting supervisory tasks in relation to

those branches as set out in articles 23b to 23d of the Regulation, including the ability to carry out on-site inspections and investigations. In this respect:

- a) credit rating agencies should cooperate with ESMA in case of inspections or investigations, including on-site visits, regarding ratings or rating activities carried out in non-EU branches;
- b) ESMA will assess the need to enter into cooperation arrangements with the local competent regulators to ensure the adequate supervision of branches located outside the Union;
- c) prior to establishing branches in third countries, credit rating agencies should ensure that those branches will abide immediately with any request set forth by the officials of ESMA in the exercise of powers pursuant to Articles 23b to 23d of the CRA Regulation, including granting of access to premises, systems and resources in case of on-site inspections and investigations.

VIII. Specific disclosure recommendations for best practice

22. ESMA recommends as a best practice that credit scoring firms that distribute credit scores to the public in the Union provide clear and prominent disclosure that those scores are not credit ratings issued in accordance with the CRA Regulation. ESMA recommends that this disclosure should be provided also by export credit agencies that act under Article 2(2)(c) of the Regulation.
23. ESMA recommends as a best practice that should credit scoring firms and export credit agencies decide to publish such information, they should retain full responsibility for the disclosure indicated in the previous paragraphs when their credit scores or ratings are distributed to the public in the territory of the Union via agreement with third parties.
24. Credit scores or ratings are distributed to the public in the EU when they are disclosed to an undetermined or undeterminable generality of individuals domiciled in the EU. Credit scores or ratings are also distributed to the public when they are issued through a website registered with a domain corresponding to one of the Member States of the EU.

IX. Enforcement of the scope of the CRA Regulation

25. ESMA shall impose periodic penalty payments in order to compel the credit rating agency to put an end to the infringement of issuing credit ratings without being registered by ESMA, and impose fines where appropriate, in accordance with Articles 36(a) and 36(b) of the CRA Regulation. This applies also to registered credit rating agencies that create impediments to the effective supervision from ESMA by carrying out entirely (or prevalently) important operational functions in branches outside the EU.
26. Where a NCA or a SCA receives an application, request for information, or any other form of inquiry concerning the CRA Regulation, including on registration or certification, the Authority should immediately notify ESMA and refer the financial market participant that has submitted the request to ESMA as the sole competent supervisory authority in the Union.