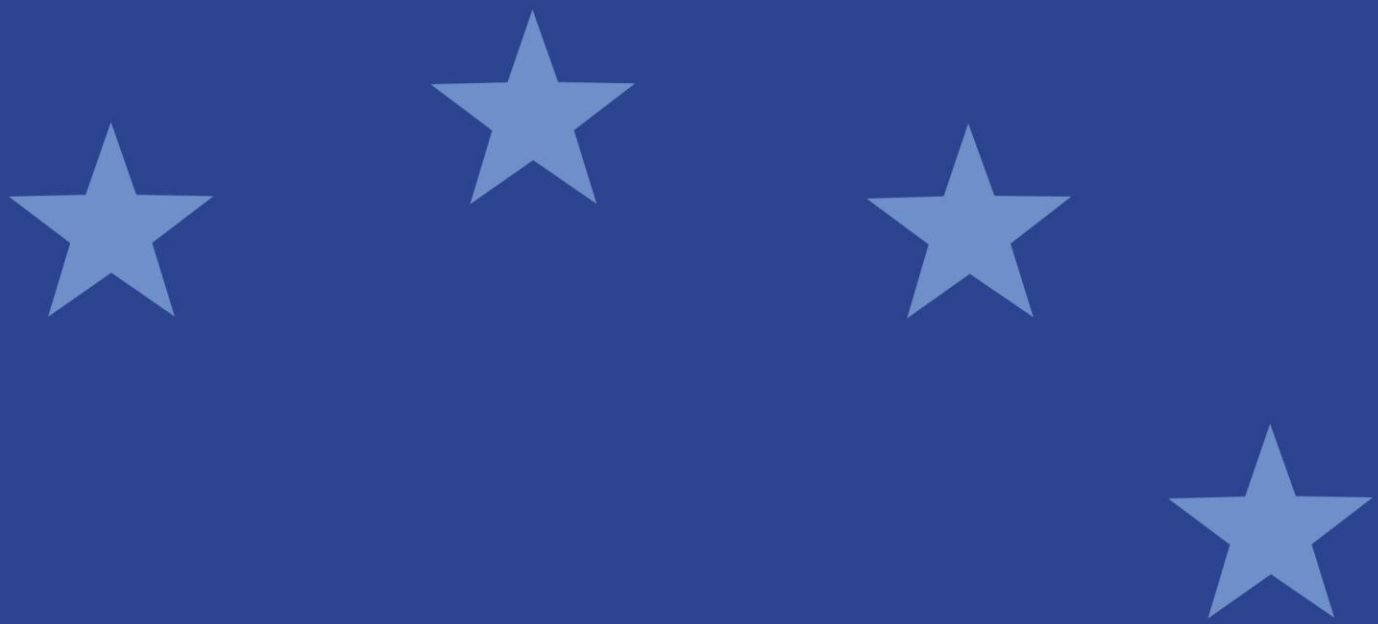
esma European Securities and Markets Authority

Final report

Technical advice on CRA regulatory equivalence – on Argentina, Brazil, Mexico, Hong Kong and Singapore.



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I- Executive summary

On 22 October 2012 the European Commission requested ESMA to provide its technical advice on the equivalence between the legal and supervisory framework of Argentina, Brazil, Hong Kong, Mexico, Singapore with the EU regulatory regime for credit rating agencies. (Regulation (EC) No. 1060/2009 of the European Parliament and the Council on credit rating agencies[1]).

On 9 October 2012, the European Commission published an equivalence decision on US, Canada and Australia. The same decision has been taken on 28 October 2010 on Japan.

With regard to the compliance with the EU requirements on endorsement, ESMA had already indicated that it considers the legal and regulatory regime for CRAs supervision of the following countries as "as stringent as" the EU requirements:

- on 15 March 2012, Hong Kong and Singapore;

-on 18 April 2012, Argentina and Mexico;

-on 27 April 2012, Brazil.

This report sets out ESMA's advice to the European Commission in respect of the equivalence between the Argentina (Part I), Brazil (Part II), Mexico (Part III), Hong Kong (Part IV) and Singapore (Part IV), respective legal and supervisory frameworks and the EU regulatory regime for credit rating agencies.

The equivalence assessment conducted by ESMA follows an objective-based approach, where the capability of the regime in the third country to meet the objectives of the EU Regulation is assessed from a holistic perspective.

With regard to Argentina, Brazil, Mexico, Hong Kong, Singapore, following ESMA's decision to consider their regulatory regimes as being in line with the requirements defined in Article 4(3) of the EU Regulation on CRA (1060/2009), the following assessments conclude that their legal and supervisory framework for credit rating agencies are equivalent to the EU regulatory regime for credit rating agencies.

A positive equivalence determination is required to enable a third country credit rating agency to apply for certification. However, ESMA reiterates that a determination of equivalence is one of the criteria that have to be met as set out in Article 5(1) of the EU Regulation. Other relevant requirements include the authorisation or registration of the CRA and its supervision in that third country. A positive equivalence determination should not be understood as meaning that a third country credit rating agency will automatically be granted certification and as such its credit ratings issued from such a third country may be used in the EU for regulatory purposes.

[1] The Regulation.

Introduction

1. The European Commission mandated CESR on 12 June 2009 to provide it with technical advice on the equivalence between the US, Canadian and Japanese legal and supervisory frameworks and the EU regulatory regime for credit rating agencies (Regulation (EC) No. 1060/2009 of the European Parliament and the Council on credit rating agencies[2]).
2. An additional mandate relating to the equivalence of the Australian legal and supervisory framework followed on 17 November 2009.
3. Since then, on 28 September 2010, the European Commission has published an equivalence decision on Japan followed by a similar decision on 22 October with regards to US, Australia and Canada.
4. With regard to the compliance with the EU requirements on endorsement, ESMA indicated it considers the legal and regulatory regime for CRAs supervision of the following countries as "as stringent as" the EU requirements:
   - Hong Kong and Singapore (15 March 2012);
   - Argentina and Mexico (18 April 2012),
   - Brazil (27 April 2012).
5. This report sets out ESMA's advice to the European Commission in respect of the equivalence between Argentina (Part I), Brazil (Part II), Hong Kong (Part III), Mexico (Part IV) and Singapore (Part IV) respective legal and supervisory frameworks and the EU regulatory regime for credit rating agencies.

Purpose and use of the European Commission's equivalence decision

6. Once an equivalence decision has been made by the European Commission, it will enable certain aspects of the EU Regulation, relating to the use of credit ratings issued outside the EU, to become operational, provided other conditions are met.
7. There are two methods in the EU Regulation through which credit ratings issued outside the EU can be used in the EU for regulatory purposes.
8. The first method is referred to as certification and is set out in Article 5 of the EU Regulation. It will allow a third country credit rating agency, whose activities are not considered to be of systemic importance to the financial stability or integrity of the financial markets of one or more Member States, to enable its credit ratings which are not considered to be of systemic importance[3] to the financial stability or integrity of the financial markets of one of more Member States to be used in the EU for regulatory purposes[4].

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[2] Hereafter the Regulation.

[3] For further details please refer to the Regulatory technical standards on the information for registration and certification of credit rating agencies published by the Commission on 30 May 2012 (http://ec.europa.eu/internal_market/rating-agencies/index_en.htm).

[4] According to Article 3(1)(g) of the EU Regulation, "regulatory purposes" means the use of credit ratings for the specific purpose of complying with Community law, as implemented by the national legislation of the Member States. Article 4(1) of the Regulation refers to the use of credit ratings for regulatory purposes by "credit institutions as defined in Directive 2006/48/EC, investments firms as defined in Directive 2004/39/EC, insurance undertakings subject to the First Council Directive 73/239/EEC of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance, assurance undertakings as defined in Directive 2002/83/EC of the European Parliament and of

9. A positive equivalence determination is required to enable a third country credit rating agency to apply for certification, however ESMA reiterates that a determination of equivalence is one of a number of criteria that have to be met as set out in Article 5(1) of the EU Regulation. A positive equivalence determination should not be understood as meaning that a third country credit rating agency will automatically be granted certification and as such its credit ratings issued from such a third country may be used in the EU for regulatory purposes.

10. Only if all the other conditions set out in Article 5(1) of the EU Regulation are met, can a third country credit rating agency be granted certification.

11. These conditions are that:

    a) the credit rating agency is authorised or registered and is subject to supervision in that third country;

    b) cooperation arrangements are operational;

    c) the credit ratings issued by the credit rating agency and its credit rating activities are not of systemic importance to the financial stability or integrity of the financial markets of one or more Member States.

12. Cooperation arrangements, as set out in Article 5(7) of the EU Regulation are necessary in order to enable home competent authorities in the EU and the relevant third country competent authority to (i) exchange information and (ii) coordinate supervision.

13. The second method is endorsement, through which an EU registered credit rating agency will be able to endorse credit ratings issued in a third country through the endorsement process set out in Article 4(3)-(6) of the EU Regulation and further specified in ESMA guidance published in May 2011 (ESMA/2011/139).

14. One of the certification conditions for a foreign credit rating agency is that the Commission has adopted an equivalence decision recognising the legal and supervisory framework of the third country as equivalent to the requirements of the Regulation. The equivalence decision would state that the legal and supervisory framework of a third country ensures that credit rating agencies authorised or registered in that third country comply with legally binding requirements which are equivalent to the requirements resulting from the Regulation and which are subject to effective supervision and enforcement in that country (Article 5(6)).

ESMA's Approach to Assessing Equivalence

15. Concerning the assessment approach taken during this technical advice, ESMA used the same approach than the methodology attached to ESMA Guidelines on the application of the endorsement requirements (ESMA/2011/139) published by ESMA on 17 May 2011[5].

16. The equivalence assessment conducted by ESMA, in fact, follows an objective-based approach, where the capability of the regime in the third country to meet the objectives of the EU

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the Council of 5 November 2002 concerning life assurance, reinsurance undertakings as defined in Directive 2005/68/EC of the European Parliament and the Council of 16 November 2005 on reinsurance, undertakings for collective investment in transferable securities (UCITS) as defined in Directive 85/611/EEC and institutions for occupational retirement provision as defined in Directive 2003/41/EC".

[5] The methodology of assessment is available at the following address: http://www.esma.europa.eu/system/files/2011_144.pdf.

Regulation is assessed from a holistic perspective.

17. Accordingly, while determining the ability of the non-EU countries to achieve the main objectives of the relevant EU requirements, the analysis grid is based upon the following seven areas:

(i) Scope of the regulatory and supervisory framework

(ii) Corporate Governance

(iii) Conflicts of interests management

(iv) Organisational requirements

(v) Quality of methodologies and of credit ratings

(vi) Disclosure of:

- credit ratings
- the activities of the credit rating agency

(vii) Effective supervision and enforcement.

Assessments of Argentina, Brazil, Hong Kong, Mexico, Singapore

Chapter I- Assessment of Argentina

Key to the references and terms used in this advice:

CRAs: credit rating agencies

CNV: Comision Nacional de Valores

AIF: Autopista de la Información Financiera (Financial Information Highway)

Executive summary

Following ESMA's decision to consider the Argentinian regulatory regime as being in line with the requirements defined in Article 4(3) of the EU Regulation on CRA, this document sets out the technical advice of ESMA in relation to the equivalence between the current Argentinian legal and supervisory framework and the EU regulatory regime for credit rating agencies, in accordance with the European Commission's mandate of 22 October 2012.

ESMA concludes that, overall, the current Argentinian legal and supervisory framework is equivalent to the EU regulatory regime for credit rating agencies in terms of achieving what ESMA considers to be the overall objective of:

"**assuring that users of ratings in the EU would benefit from equivalent protections in terms of the credit rating agencies integrity, transparency, good governance and reliability of the credit rating activities**".

In coming to this conclusion, ESMA has assessed whether the current legal and regulatory framework for Credit Rating Agencies in Argentina met the EU Regulation requirements grouped into seven areas6 as detailed in the ESMA Guidelines of 17 May 2011. In relation to each of which ESMA has assessed the ability of the Argentinian legal and supervisory framework to achieve the main objectives of the relevant EU requirements. Nevertheless, a third-country CRA can only be granted "certification" if all the conditions set out in Article 5(1) of the EU Regulation are met, for example that the CRA is authorised or registered in and subject to supervision in that third country.

ESMA considers the current Argentinian framework to be comprehensive and in many instances similar to the EU Regulation.

There are no areas where the Argentinian main features do not meet the objectives of the EU requirements; there are no shortcomings. Consequently ESMA has no recommendations to make in respect of the Argentinian legal and supervisory framework on the whole for the purposes of an equivalence decision by the European Commission.

However, the Argentinean Congress adopted Law No. 26.831 on "Capital Markets Law" in November 2012. This new Law aims to set up a new regulatory framework for the entire Argentinean Capital Markets including CRAs legal framework. Law 26.831 empowers CNV to carry out the reform through a new CNV's Regulation. The new CNV's Regulation is foreseen to be adopted by July 2013 and implemented during the second half 2013.

ESMA will keep on monitoring the evolution of the Argentinian legal and supervisory framework for credit rating agencies on an on-going basis and cooperate with the Argentinian Authorities via the Memorandum of Understanding signed with the Comision Nacional de Valores of Argentina in this field in April 2012 (ESMA/2012/256). In the event of any future change into the Argentinian regulatory and supervisory regime which may trigger a change in the conclusions of this report, ESMA will appropriately inform the European Commission.

[6] These seven areas are:
1. The scope of the regulatory and supervisory framework
2. Corporate Governance
3. Conflicts of interest management
4. Organisational requirements
5. Quality of methodologies and quality of ratings
6. Disclosure
7. Effective supervision and enforcement.

Assessment of Argentina

18. This section of the report explains how ESMA assesses the equivalence between the Argentinean regulatory and supervisory framework and the EU regulatory regime for credit rating agencies.

19. This section is divided as follows:

    a) The Argentinean legal and supervisory framework

    b) The assessment of the equivalence on that framework to that of EU

20. This section outlines the general differences between the EU and the Argentinean approach on implementing the credit rating agency registration and oversight regime.

a) The Argentinean regulatory and supervisory framework

Overall philosophy of approach

21. Argentinean CRAs have been regulated, registered and supervised since 1992. The main Argentinean legal texts in relation to credit rating agencies are (i) Chapter XVI – Credit Rating Agencies - of Comision Nacional de Valores (CNV) Regulation adopted in 2001 (level 2 regulation issued by CNV) and (ii) the information regime set under Chapter XXVI – Autopista de la Informacion Financiera or Financial Information Highway – as well as information and explanations on the relevant provisions provided by the staff of the CNV.

22. Chapter XVI of CNV Regulation was amended by the General Resolution 605/12 modifying the regulatory framework applicable to CRAs with the aim to align Argentinean CRAs' regulation with the international regulation in this field. The regulatory update set new requirements that affect (i) the corporate governance of the CRAS; (ii) ratings and rating methods; (iii) reporting; and (iv) conflicts of interest.

23. The Argentinean Congress adopted Law No. 26.831 on "Capital Markets Law" in November 2012 which abrogates Decree 656/1992 as amended by Decree 749/2000. This new Law aims to set up a new regulatory framework for the entire Argentinean Capital Markets including CRAs legal framework. Law 26.831 only contains articles 57 and 58 with regard to CRAs and empowers CNV to carry out the reform through a new CNV's Regulation (secondary legislation). The new Regulation is foreseen to be adopted by July 2013 and implemented during the second half 2013.

24. At the moment of the drafting of this report, there is no draft CNV's Regulation yet. However, CNV officials have informed ESMA about some of the main features of the planned CNV Regulation. In particular:

    (i) remove the corporate form requirement of being a "Corporation" (Sociedad Anonima) in order to be registered as a CRA in Argentina. This measure will open up the CRA market to other type of organisations and mostly, to Federal Public Universities;

    (ii) require CRA's rotation each five years;

    (iii) include in the Regulation an Annex containing the IOSCO Code of Conduct which will have to be complied with by CRAs in Argentina(similar to other third countries jurisdictions e.g. Australia or Honk Kong);

(iv) introduce new deadlines to submit documents to CNV through the AIF;

25. CNV has also informed ESMA that the planned CNV's Regulation does not expect to relax any of the requirements previously adopted by the CNV's Resolution 605/12 on which basis ESMA built on the endorsement decision on 18 April 2012. New CRAs, including Federal Public Universities, should be registered with and under the control of the CNV.

26. Comision Nacional de Valores (CNV) is the enforcement authority of the previous rules and therefore, responsible for registration and supervision of CRAs. CNV's supervisory and sanctioning competences are set up by Law 17,811 establishing the CNV (16 July 1968).

27. Up-to-date, the Argentinian legislative and regulatory framework is very close to that of the EU Regulation in terms of the legal and supervisory framework that has been established for the oversight of credit rating agencies. CNV's Resolution 605/12 further aligned Argentinean legislation with the EU Regulation.

b) The assessment of the equivalence on Argentinean framework to that of EU

28. As a background to this advice, on 18 April 2012, ESMA informed market participants that the regulatory regime for CRAs in Argentina embeds requirements which closely follow those in place in the EU. Consequently, the regulatory and supervisory framework in Argentina was assessed as fulfilling the "as stringent as" test set out in Article 4(3) (b) of the CRA Regulation 1060/1009.

29. The regime adopted in Argentina has been tested against the objectives pursued by the EU Regulation grouped into seven areas, as detailed in ESMA's Guidelines on Endorsement (ESMA/2011/139, Annex II). These areas are as follows:

(I) the scope of the regulatory and supervisory framework;

(II) corporate governance;

(III) management of conflicts of interest;

(IV) organisational requirements;

(V) quality of methodologies and of ratings;

(VI) general disclosure and presentation of ratings;

(VII) effective supervision and enforcement.

30. Finally, as regards the cooperation arrangements required by Article 5 (7), a MoU between ESMA and the CNV concerning supervision of CRAs has been established on 17 April 2012.

I. The scope of the regulatory and supervisory framework in Argentina

31. CRAs issuing credit ratings on securities subject to public offerings must be registered with CNV, who is the authority responsible for supervising and enforcing that CRAs comply with the regime. CNV has confirmed that it exercises its supervisory powers over securities, entities and instruments subject or not to the public offer regime.

32. **As regards the definition of the CRAs**, CRAs are specialised firms whose corporate purpose is to satisfy the demand for information from investors by evaluating the credit risk of securities which are subject to public offering. In addition to this, CRAs have the exclusive purpose of rating of securities and other values.

33. When Decree 656/92 was published in 1992, the rating activity was linked to the issuance of securities because at that time, those issuances had to be accompanied by at least two ratings. CNV and the CRAs registered in Argentina have provided ESMA with letters where explain the legal basis that supports that the CRA's regime applies as well to ratings issued on other debt instruments which are not subject to public offering. This has been currently confirmed with the Law No 26.831 (Article 58).

34. **As regards registration of CRAs**, CNV keeps the Credit Rating Agencies Register where those companies interested in obtaining enrolment to rate securities authorized for public offer within the Republic of Argentina shall register, same being the Agency in charge of such supervision. Upon request of the issuers, the credit rating agencies may also rate any other security, subject or not to the public offer regime. CNV may also register entities interested in rating other kind of risks, prior the consultation and conformity with the relevant regulatory or control bodies

35. **As regards the non-interference with ratings**, there are not a specific provisions in the Argentinian regulation explicitly forbidding for any interference or influence on the content of rating or on CRA methodologies by the CNV.

36. Certain areas of potential interference were initially identify such as (i) submission of methodologies for registration with the CNV and publication on CNV's webpage; (ii) provisions regarding the rating committee composition, assistance of CNV officers, and notification of the meeting 72 hours in advance to CNV and submission of the minutes and other documents to the CNV after the meeting; (iii) mandatory use of rating categories; (iv) and possible intervention in case of disagreement on fees as previously there was an obligation to use at least 2 CRAs for each issue. Most of these interferences were cleared in the course of the equivalence assessment.

37. Additionally, two of them, CRAs filing their methodologies with CNV and the assistance of CNV officers in rating committees for supervisory purposes, have been underpinned by CNV through a letter stating that there is no possibility of interference in any of them.

ARGENTINIAN's LEGAL AND REGULATORY FRAMEWORK FOR CRA	**BOX 1**
Argentina has a comprehensive and legally binding framework in relation to CRAs and the use of credit ratings. The Argentinian regime is in force since 1992. Four credit rating agencies are currently registered and supervise by the Comision Nacional de Valores (CNV). All relevant laws and regulations have entered into force. ESMA considers that both the EU and Argentinian regulatory and supervisory regimes for credit rating agencies share the same overall objectives namely, to ensure that CRA ratings are carried out fairly and from an independent standpoint.	

II. Corporate governance

38. The EU mandate on assessing the equivalence between certain non-EU countries and the EU regulatory regime for CRAs required ESMA to at least check that" two independent directors of the CRA's administrative or supervisory board are tasked with monitoring the credit rating policies, effectiveness of the internal quality control system as well as the internal controls and measures established to deal with conflicts of interest".

Argentinian approach to corporate governance

39. As regards **corporate form and governance structure**, according to Argentinian regulation at the time of drafting this report, CRAs shall adopt the form of a corporation (Sociedad Anonima) and shall be governed by a board of Directors. The chairman of the board of directors has the legal representation of the company and thus, has wide powers of acting on its behalf. The directors shall have due honesty, possess sufficient capacity and experience and ensure a sound and prudent management of the CRA. The majority of the members of the supervisory board shall have enough technical knowledge in the field of financial services. Where the CRA issues credit ratings on structured finance instruments, at least 2 directors shall have sufficient knowledge and experience in the field of markets of structured finance.

40. The board of directors is composed of at least three directors. The Argentinian regulation does not stipulate that the members of the board of directors shall be independent. However, it established the following obligations for board members (i) the directors are responsible for the compliance of the CRA with Decree 656/92 and the CNV Regulations (ii) the directors shall ensure a sound and prudent management of the CRA and (iii) the directors shall ensure that the rating activities are independent and that conflicts of interest are adequately identified, managed and disclosed.

41. Following Law No 26.831 a new regulation is foreseen in order to remove the corporate form requirement of being a "Corporation" (Sociedad Anonima) in order to be registered as a CRA in Argentina. This measure will open up the CRA market to other type of organisations and mostly, to Federal Public Universities;

42. As regards **monitoring function**, according to the CNV Regulation, the CRAs shall establish and maintain a permanent and efficient compliance function which operates independently and reports directly to the supervisory board. The monitoring tasks that are conferred to independent directors under the EU Regulation have been conferred under the Argentinian regime to an independent compliance officer who: (i) reports directly to the supervisory board; (ii) has authority, resources, knowledge and necessary access to all the relevant information; (iii) does not participate in rating

activities; and (iv)whose compensation is not linked to the performance of the rating activities and is established in a way that ensures his/her independence.

43. Furthermore, the review of methodologies shall be carried out by officers which are not involved in rating activities and who report to the supervisory board.

44. According to the methodology for the assessment of third country regimes[7], the monitoring tasks assigned to independent members of the board "do not need to be carried out by senior management per se, but in order for the objective of the EU requirement to be met, what is important is that these monitoring tasks are carried out by someone independent, who is not involved in credit rating activities, and whose compensation is arranged in such a way to ensure the independence of their judgment and the absence of links to the business performance of the credit rating agency".

CORPORATE GOVERNANCE	**BOX 2**
Overall, ESMA considers that the Argentinean legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to corporate governance although the Argentinian regime follows a different philosophy with similar results. The monitoring tasks that are conferred to independent directors under the EU Regulation have been conferred under the Argentinian regime to an independent compliance officer.	

III. Conflict of interest Management

45. The EU mandate required ESMA to check at least the following issues in this section:

- a CRA identifies and eliminates (or manages and discloses) conflicts of interest;
- a CRA ensures that business interest does not impair the independence and accuracy of ratings;
- A CRA refrains from issuing a rating when it has direct or indirect interest in the entity asking for a rating;
- a CRA does not provide consultancy or advisory services;
- rating analysts cannot make proposals or recommendations on the design of structured finance products;
- rating analysts are not involved on the negotiation of the fees or payments with any rated entity, related third parties or any person directly or indirectly linked with the rated entity by control;
- rating analysts compensation and performance evaluation is de-linked from the revenue they generate from the CRA
- a stringent rotation policy is put in place.

[7] Paragraph 104 of the Guidelines on the application of the endorsement regime under Article 4 (3) of the Credit Rating Agencies Regulation No 1060/2009 (ESMA/2011/139).

Argentinian approach to conflict of interests management

46. As regards **management and avoidance of conflicts of interest**, under the Argentinian regime, the members of the supervisory board shall ensure that the rating activities are independent and that conflicts of interest are adequately identified, managed and disclosed.

47. In particular, Chapter XVI of CNV Regulation states that CRAs shall adopt all necessary measures to ensure that the issuing of a credit rating is not impaired by any conflict of interest or business relationship, real or potential, that involve that CRA, its managers, analysts, employees or any other person whose services are placed at the disposal of the CRA, or any person directly or indirectly linked to it by control. CRAs shall be organised in such a manner that its commercial interest do not impair the independence or accuracy of its rating activities.

48. CRAs shall also adopt adequate and efficient organisational and administrative arrangements with the aim to avoid, identify, eliminate or manage and disclose all conflicts of interest. CRAs shall record significant risks that affect or might affect the independence of rating activities and the protection measures applied in order to mitigate these risks.

49. Furthermore, CRAs shall submit and maintain updated through AIF "Autopista de la informacion financiera" information on the actual and potential conflicts of interest related to the members of the rating committee, members of the supervisory board, managers and employees.

50. With regard to **ownership possible conflict of interest rules,** according to Article 15 of CNV Regulation, CRAs in Argentina shall not issue a credit rating where (i) the credit rating agency or rating analysts, employees or any other natural person whose services are placed at the disposal or under the control of the credit rating agency who are directly involved in the issuing of credit ratings and persons approving credit ratings, directly or indirectly owns financial instruments of the rated entity or any related third party or has any other direct or indirect ownership interest in that entity or party other than holdings in diversified collective investment schemes or managed funds including pension funds and life insurance; (ii) the credit rating is issued with respect to a rated entity or any related third party directly or indirectly linked to the credit rating agency by control; (iii) rating analysts, employees or any other natural person whose services are placed at the disposal or under the control of the credit rating agency and that participate directly in rating activities is a member of the administrative or supervisory boards of the rated entity or any related third party; and (iv) an analyst who participated in determining a credit rating, or a person who approved a credit rating, has had any relationship with the rated entity or any related third party thereof, which may potentially cause a conflict of interests.

51. As for **disclosure of names of main rated entities**, the Argentinian regime does not provide disclosure of the names of the rated entities or related third parties from which it receives more than 5% of its annual revenue. However, CRAs inform the CNV on a quarterly basis of the amount of the fees charged per service provided. This information shall be disaggregated by instrument, amount, duration of the process, affected personnel and information used. CNV uses the fees information for supervisory purposes and discloses quarterly the range of charged fees disaggregated by instrument. Furthermore, CNV is informed of any agreement signed between a CRA and a new issuer prior the rating takes place.

52. According to the methodology for the assessment of third country regimes[8], the disclosure regarding the names of clients from whom CRAs receive more than 5% of their annual revenue can be made only to the regulator so that it can monitor and supervise how CRAs are managing the conflicts that arise in respect of clients. CNV is informed immediately of any new agreements signed by a CRA and receives quarterly information on the fees charged per client for supervisory purposes[9].

53. As for **ancillary services**, CRAs in Argentina shall ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity and shall disclose in the final ratings reports any ancillary services provided for the rated entity or any related third party.

54. Article 5 of Chapter XVI of CNV Regulation allows CRAs to render other services different from the issuance of credit ratings ("**Ancillary services**"), for which they must have the prior authorization of the CNV. In those cases, CRAs will have to ensure that the rendering of ancillary services does not imply a conflict of interests with the credit rating activities, and will disclose in the final rating reports the ancillary services rendered to the rated entity or third related parties. Additionally, according to Article 35, those ancillary services have to be disclosed to CNV. CRAs have to submit and immediately update through the Autopista de la Informacion Financiera the list of ancillary services previously authorised by CNV.

55. As regards **consultancy or advisory services**, Argentinian CNV Regulation expressly forbids the provision of advisory or consultancy services. Additionally, rating analysts and members of the rating committee will not request or accept money, gifts or favours from anyone with whom the credit rating agency does business.

56. With regard to **involvement of rating analysts in the negotiation of fees,** according to the Argentinian legislation, rating analysts and rating committee members cannot initiate or participate in the negotiation of the fees or payments with any rated entity related third party or a person directly or indirectly linked to the rated entity by control with the rated entity. In addition, CRAs are required to ensure that rating analysts or persons that approve ratings cannot make proposals or recommendations, formally or informally, regarding he design of structured finance products about which the CRA is expected to issue a rating.

CONFLICT OF INTEREST MANAGEMENT **BOX 3**

ESMA considers that, overall, the Argentinian legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation of conflicts of interest management, and points out that the framework includes provisions which are similar in the large majority to those of the EU Regulation. Argentinean regime follows a different philosophy with similar results.

[8] Paragraph 119 a) of the Guidelines on the application of the endorsement regime under Article 4 (3) of the Credit Rating Agencies Regulation No 1060/2009 (ESMA/2011/139).
[9] Points b.8 and b.12 Article 2 Chapter XXVI CNV Regulations.

IV. **Organisational requirements:**

57. The EU mandate required ESMA to check that as a minimum a CRA keeps records and audit trails of all its activities and has a compliance function which operates independently. In addition, ESMA's approach to assessing the equivalence of the regulation's organisational requirements can be divided into the following areas:
    - general organisational requirements
    - outsourcing
    - confidentiality
    - record keeping.
58. The overall objective the organisational requirements is that they contribute to ensuring the objectivity, independence, integrity and quality of the credit rating activities.

Argentinian approach to organisational requirements

59. With regard to **the general organisational requirements**, article 3 of Chapter CNV Regulation states that CRAs shall have appropriate administrative and accounting procedures, effective internal control mechanisms and safeguard their informatics systems, and effective risk appraisal techniques. Such internal control mechanisms shall be designed in order to guarantee the compliance with the decisions and procedures at all the levels of the CRA. Credit Rating Agencies shall also apply and maintain decision-taking procedures and organizational structures which specify in a clear and documented manner the information channels, and assign duties and responsibilities.
60. Additionally, CRAs in Argentina shall evaluate the suitability and effectiveness of its systems, internal control mechanisms and procedures, and will adopt the necessary measures to rectify any possible deficiency.
61. As for the **compliance function and officer**, article 9 of Chapter XVI of CNV Regulation establishes that CRAs agencies shall set up and keep a permanent and effective function of compliance verification, operating in an independent manner and reporting directly to the Board of directors. The compliance function will supervise the fulfilment by the credit rating agencies and its employees of the obligations on credit rating agencies pursuant to Decree No. 656/92 (as amended by Decree No. 749/00), this Chapter ant its amendments, and will accordingly report. The responsibilities of the independent members under the EU Regulation have been conferred to the compliance function in Argentina.
62. The remuneration of the compliance officer shall not be linked to the performance of the CRA and shall be established in a way that ensures its independence.
63. With regard to **outsourcing functions**, there is not a general prohibition for outsourcing CRA functions. However, article 11 of Chapter XVI of CNV Regulation expressly declares that major operational functions will not be outsourced so that neither the rating agency's internal risk quality is significantly harmed, nor the ability of the Comision Nacional de Valores to control that rating agencies comply with the obligations set forth in Decree No. 656/92, CNV regulations and its

amendments.

64. With regard to the **confidentiality requirements**, the Argentinean legal framework covers EU requirement in Section VIII of Chapter XVI of CNV Regulation "Prohibition to use confidential information" both in terms of the scope of the persons subject to the confidentiality requirements and the measures to be established in order to protect all property and records relating to credit rating activities.

65. In particular, article 46 of Chapter XVI states that CRAs will ensure that rating analysts, its employees and any individual whose services are available to them or under its control and who are directly involved in the credit rating activities (i) take all reasonable measures to protect property and documentation in possession of the credit rating agency against any fraud, theft or misuse, taking into account the nature, scope and complexity of its operations and the nature and extent of its credit rating activities; (ii) do not disclose any information about credit ratings or possible future credit ratings of the agency, except to the rated entity or related third parties; (iii) do not disclose confidential information entrusted to the credit rating agency, to the rating analysts and employees of any person directly or indirectly linked to it by control, or any other individual whose services are made available or under control of any person directly or indirectly linked to the agency by a relation of control, and which directly participates in the credit rating activities; and (iv) do not use or disclose confidential information for the purposes of trading financial instruments or any other purpose other than the performance of credit rating activities.

66. The Argentinean regulatory framework contains **record-keeping requirements** and an extensive list of document to be kept. According to this legislation, CRAs in Argentina shall have to keep for a period of ten years all documents listed in Article 44 of the CNV Regulation.

ORGANISATIONAL REQUIREMENTS	**BOX 4**
Overall, ESMA considers the Argentinean legal and regulatory framework meets the objectives of the EU requirements in respect of the organisational requirements that a CRA needs to have in place in the areas of the general organisational, outsourcing, confidentiality and record keeping. Argentinean regime follows a different philosophy with similar results.	

V. Quality of methodologies and of ratings

67. As specified in the EU commission mandate, the objective of this section is to assess the following criteria:

- that competent authorities do not interfere with the content of ratings or the CRAs methodologies
- a CRA has a function devoted to the periodical review of methodologies and models
- A CRA applies consistently the changes in methodologies and models to existing ratings
- a CRA monitors its ratings and methodologies on an on-going basis and at least annually

Argentinian approach to quality of rating methodologies and ratings

68. Under the Argentinean regime, CRAs shall adopt all necessary measures so that the information they

use in assigning a credit rating is of sufficient quality and from reliable sources. CRAs must apply rigorous, systematic, continuing rating procedures, and that can be validated from the historical experience, which must be described in manuals previously registered with the Comision Nacional de Valores, which will clearly contain the steps to be followed within the rating process.

69. Additionally, CRAs shall adopt, implement and enforce adequate measures to ensure that the credit ratings they issue are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis according to their rating methodologies.

70. As for the **knowledge and experience of employees directly involved in credit rating activities**, Article 27 of Chapter XVI of CNV Regulation states that CRAs must ensure that rating analysts, its employees and any other individual whose services are made available or under its control and who are directly involved in credit rating activities have appropriate knowledge and experience for the duties assigned.

71. With regard to the **review of methodologies and models**, Articles 17 and 18 of Chapter XVI of CNV Regulation requires that CRAs shall perform a follow-up of their methodologies ("*procedures of rating*") on a permanent basis, which will be reviewed at least once per year by officers that are not involved in the credit rating activities, and who report to the members of the board of directors. The "procedures for rating" shall be described in the "Manual of procedures" which shall clearly contain all the steps to follow in the rating process. CNV understands that methodologies, models and key rating assumptions are encompassed in the "procedures of rating".

72. CRAs shall also **monitor credit ratings and revised ratings** at least four times per year. Furthermore, the revision shall specially be carried out when substantial changes occur that might have an impact on a credit rating. CRAs shall establish internal mechanisms in order to control the impact that the changes may have in the macroeconomic and financial market conditions over credit ratings.

73. Under the Argentinean regime, **when a methodology is changed**, CRAs shall:

    (a) immediately, using the same means of communication as used for the distribution of the affected credit ratings, disclose the likely scope of credit ratings to be affected;

    (b) review the affected credit ratings as soon as possible and no later than six months after the change, in the meantime placing those ratings under observation; and

    (c) re-rate all credit ratings that have been based on those methodologies, models or key rating assumptions if, following the review, the overall combined effect of the changes affects those credit ratings.

74. However, there is no provision under the Argentinean regime establishing that when methodologies, models or key rating assumptions used in credit rating activities are changed, CRAs shall apply the changes in methodologies and models "consistently" to existing ratings. Despite the lack of legal provision, the consistency objective is met under the amended Argentinean regulation due to the fact that CRAs are not able to use new methodologies or changes to methodologies unless they are registered with the CNV for publication and CRAs have to rate according to the new registered methodologies (Article 35.c Chapter XVI of CNV Regulation).

75. As regards **refraining from rating in case of insufficient information**, as above-mentioned, CRAs are obliged to re-rate credit ratings at least 4 times per year. Categories A, B, C or D shall be used for those securities issued by issuers that have satisfactorily complied with the information requirements of the current regulations and the necessities of the credit rating agency. CRAs shall assign the rating Category E to those issuer's securities that did not satisfactorily comply with the

information requirements for rating a security.

76. Article 14 of Chapter XVI of CNV Regulation specifies that CRAs shall rate with the letter "E" or number "5" (i) securities owned by the issuers that have not complied with the requirements of information provided by the current regulations, and necessary for the rating of its securities; and (ii) risks over which the solicitor of the rating did not furnish all the information that is necessary to issue an opinion. Users of credit ratings are informed on the definition of Category E in the rating report.

77. Consequently, under the Argentinean regime, if the information is not of adequate quality or insufficient, then CRAs have to disclose that the rating is Category E so as to flag to the public that they cannot rate the issuer. The objective is similar to the objective stated by the EU Regulation.

QUALITY OF RATING METHODOLOGIES AND RATINGS	**BOX 5**
ESMA considers that the overall approach towards quality of methodologies and credit ratings in Argentina is along the line of the EU requirements in this area. Argentinean regime follows a different philosophy with similar results.	

VI. **Disclosure of credit rating**

78. For the purpose of this advice, ESMA has divided the requirement related to disclosure of credit rating into the following categories:

    - the presentation and disclosure of credit ratings, and
    - general and periodic disclosure about CRA.

Argentinian approach to disclosure of credit ratings

Disclosure of credit ratings

79. With regard to the **disclosure of credit ratings**, under the Argentinean regulation, CRAs shall published the credit rating immediately after the rating committee and submit to CNV all ratings reports for publication through the "Autopista de la informacion financiera" (Financial Information Highway) on CNV's webpage (Article 23, Chapter XVI, CNV Regulation).

80. The Argentinean regulation does not request the disclosure in the rating report of the date at which the credit rating was first released for distribution and when it was updated. However, in Argentina, rating reports are filed with CNV for publication. On CNV's web page, the reports are linked to the relevant security and stored by date of publication for investors to read them. Consequently, users are able to identify the date of the last up-date and the first report as all historical reports are available in CNV's web-page.

81. According to Article 13 of Chapter XVI of the CNV Regulation, the **rating report content** shall (i) mention the sources of information considered to obtain the data used in the respective analysis, clearly setting the analysis performed and the results obtained in each stage of the rating and (ii) make express reference to the different analysis performed and its results in each of the stages of the rating process, which shall be provided in the registered "Manual of procedures" (containing the

methodology), including the quantitative and qualitative parameters (for instance, indexes, guidelines used in the drafting of the projected financial statements, analysis of market in which the issuer is present, etc.).

82. CRAs in Argentina shall ensure that at least (i) all substantially important sources, including the issuer, or a related third party, used to prepare the credit rating are included in the rating report; (ii) the Manual of procedures (containing the methodology) used to determine the credit rating is identified in the rating report; and (iii) the meaning of the rating categories and the definition of default or recovery has to be indicated in the rating report (Article 37, Chapter XVI).

83. CRAs shall also ensure that the rating reports clearly and prominently contain the name and job title of the person which is primary responsible for the approval of the credit rating (Article 36, Chapter XVI).

84. Under the EU rules, CRAs are required to state clearly and prominently when disclosing credit ratings any attributes and **limitations of the credit rating** and to what extent it has examined the quality of information used in the rating process and whether it is satisfied with the quality of information it bases its rating. As explained above, under Argentina's regime, if a CRA is not satisfied with the quality of the information or has limited access to information, the CRA shall issue a "Category E" rating flagging to the public that the issuer could not be rated. There is no room under the Argentinean rules to rate with *limitations* although similar objective is fulfilled through the rating "E".

85. Under the Argentinean legislation, CRAs are not forbidden to **use the name of any relevant authority** in such a way that would indicate or suggest endorsement or approval by that authority. Nevertheless, CNV has the tools to supervise that this is not the case and in addition to this, CNV receives all rating reports for publication so that it can check it.

86. The Argentinean regulatory regime does not foresee the existence of **unsolicited ratings**. CRAs cannot issue unsolicited ratings and are only authorised to issue ratings if the issuer has expressly agreed through a rating agreement.

87. Regarding the presentation of **ratings on structured finance instruments**, under the CNV amended Regulation, a CRA shall indicate in the rating report the loss and cash-flow analysis that has been performed or upon which the credit rating is based, as well as any indication of the possible variations in the credit rating. Furthermore, it must precise the level of the analysis performed in relation to the due diligence processes carried out with respect to the financial instruments or other structured finance instruments' underlying assets.

Disclosure concerning the credit rating agency and its activities

88. With regard to **general and periodic disclosure about CRAs**, Argentinean CRAs provide general and periodic information to CNV. The list of documents and information to be submitted is contained in Articles 35, 38, 39 and 41 of Chapter XVI of CNV Regulation. However, not all documents and information submitted to CNV are published on its webpage. Among others, CNV published on its website: rating reports, quarterly and annual audited financial statements, range of fees charge for its services by type of instrument, data on historical performance (including ratings transition frequency and information about credit rating issued in the past and on their changes), historical default rates of its rating categories indicating if the historical rates have changed over time, rating Manual of procedures, Board of directors and shareholders' meetings or the name of the person in charge of the compliance function.

89. Article 5 of Chapter XVI of CNV Regulation allows CRAs to render other services different from the

issuance of credit ratings ("**Ancillary services**"), for which they must have the prior authorization of the CNV. In those cases, CRAs will have to ensure that the rendering of ancillary services does not imply a conflict of interests with the credit rating activities, and will disclose in the final rating reports the ancillary services rendered to the rated entity or third related parties. Additionally, according to Article 35, those ancillary services have to be disclosed to CNV. CRAs have to submit and immediately update through the Autopista de la Informacion Financiera the list of ancillary services previously authorised by CNV.

90. Although CNV does not publish the list of ancillary services, CRAs shall disclose in the rating report the ancillary services provided to the rated entity or related third parties. Consequently, the objective of information for supervisory purposes and investor protection would be met under the Argentinian regime.

91. Article 41 of Chapter XVI of CNV Regulation requires Argentinean CRAs that all agreements ("**Compensation arrangements**") executed with the entities that have required its services shall contain the issuers´ express acceptance and immediately informed prior to the rating to the CNV about (i) the date, duration and scope of the agreement; (ii) the contracting entity; (iii) the risk to be rated, providing detail of the applicable instruments to be rated; and (iv) the express conformity of all the intervening parties. In addition, CRAs shall immediately inform the CNV about any termination or amendment of the clauses originally agreed.

92. The CNV Regulation (Article 38.b) ads that members of the supervisory and/or control bodies shall immediately inform CNV of any material fact including any modification or cancellation of the clauses originally agreed, explaining the reasons on which it is based.

93. CRAs in Argentina shall quarterly disclose through the "Autopista de la Informacion Financiera" the **range of the fees charged** for their services, disaggregated by type of instrument or entity, when they rate securities and other risks, summarized quarterly and annually by instrument at the quarter's closing date. The presentation made by the rating agencies on the fees charged must also be disaggregated by instrument, amount, duration of services (discriminating whether it is initial or an update), affected staff and information used. Such obligation shall be effective when the first opinion is issued.

94. This disaggregated information on fees is not totally disclosed on CNV's webpage, only a range of the fees charged by type instrument is publicly disclosed. Nevertheless, CNV uses the full detailed information on fees for supervisory purposes.

95. According to Article 21 Chapter XXI CNV Regulations, each CRA shall adopt an **Investor Protection Code** regulating the behaviour of its staff, ensuring among others the safety and efficiency of the services it renders, confidentiality and prevention of potential conflicts of interest. The Code and its updates are to be submitted through "Autopista de la Informacion Financiera" and published on CNV's webpage and on the CRA's webpage.

96. As regards the **CRAs' financial information disclosure**, Chapter XXVI of CNV Regulation requires that CRAs shall submit to CNV their audited quarterly and annual financial statements. These statements are published on CNV's webpage. Consequently, the general objective of information disclosure on revenue generation would be met.

97. CRAs shall also submit through "Autopista de la informacion financier" a description of the internal control mechanism that ensures the quality of rating activities, a description of CRAs' record keeping policy and the outcome of the annual internal review of the CRAs' independence compliance function.

98. The Argentinean regime does not provide disclosure of the names of the rated entities or related third parties from which it receives more than 5 % of its annual revenue.

DISCLOSURE OF CREDIT RATINGS	**BOX 6**
Overall, ESMA considers the Argentinean legal and regulatory framework meets the objectives of the EU requirements in respect of the disclosure of credit ratings. Argentinean regime follows a different philosophy with similar results.	

VII. Effective supervision and enforcement

99. ESMA considers essential that equivalent supervisory powers than those in place in the EU are embedded in the relevant third country regulatory and legal framework. The necessary powers is the power to a access to any document, request information from any person, carry out on-site inspections and require records of telephone and traffic data.

100. In addition, the third country needs to be able to take supervisory measures following a legal breach by a CRA.

101. On the whole, Law 17,811 sets out the administrative organization of CNV. CNV is an autarkic entity having jurisdiction over the entire territory of Argentina. Section 2 of the Law stipulates that the functions of the CNV are carried out through a Board of Directors of five members appointed by the Executive Power. Each member must have recognized competence in the subject matter for which she/he is appointed, duly accredited by her/his qualifications or professional activities.

102. According to section 6 of Law 17,811, CNV is empowered to:

(a) supervise compliance with applicable laws, rules and regulations in all matters within the scope of this Law;

(b) declare irregular and inefficient, for administrative purposes, the acts subject to their control, when the acts are against the law, the regulations passed by CNV, the by-laws or the regulations.

103. More concretely, according to section 7 of Law 17,811, CNV establishes the rules that natural or legal persons involved in any capacity in the public offering of securities must observe for the purpose of evidencing compliance with the requirements herein set forth. In the exercise of its functions it may:

(a) require reports and carry out inspections and investigations in respect of natural or legal persons subject to its supervisory authority;

(b) request the aid of law enforcement agencies;

(c) initiate legal actions;

(d) report crimes or prosecute in court.

104. CRAs are considered to be "persons involved in any capacity in the public offering of securities". CNV is therefore empowered to use the supervisory powers set out in section 7 for the supervision of CRAs.

105. In addition, according to CNV's explanations, the definition of "reports" including in section 7 of Law 17,811 should be understood in a broad sense. CNV staff also clarified that there is a power to

request telephone records from courts.

106. In case of breach of the above-mentioned provisions and, beyond the professional, criminal or regular liabilities that may correspond, the CNV may, after opening a dossier, impose those penalties prescribed by Section 10 of Argentine Law 17,811, suspend temporarily or definitively those responsible as well as suspend or cancel the company's enrolment (withdraw the CRAs registration or authorisation) depending on the severity of the fault (section 25 Decree 656/92).

107. With regard to penalties, Section 25 of Decree 656/92 empowers CNV to impose the penalties prescribed by Section 10 of Law 17,811. CNV is entitled to impose, among others, the following penalties: (i) censure; (ii) fines from ARS 1,000 to ARS 1,500,000; each such amount may be increased up-to 5 times the amount of the obtained benefit or the damage suffered as a consequence of the illegal action, if any of them is higher; (iii) prohibition for a maximum period of 5 years to carry out activities as director, auditor, member of the Rating Committee.

108. Finally, according to Section 10 bis of Law 17,811, CNV shall keep a public register of the imposed penalties, where the successive resolutions until the last legal instance shall appear as well as the data of the responsible parties and the measures adopted regarding that matter.

EFFECTIVE SUPERVISION AND ENFORCEMENT **BOX 7**

For the purposes of carrying out its oversight tasks, ESMA considers the Argentinean legal and regulatory framework empowered CNV with an equivalent range of powers than those in place in the EU. Argentinean regime follows a different philosophy with similar results.

c) Conclusion on the equivalence status regarding the Argentinean legislative and regulatory framework

GLOBAL ASSESSMENT **BOX 8**

ESMA concludes that overall the Argentinean legal and supervisory framework is equivalent to the EU regulatory regime for CRA in terms of what ESMA considers to be the overall objective of:

"assuring that users of ratings in the EU would benefit from equivalent protections in terms of the CRAs integrity, transparency, good governance and reliability of the credit rating activities"

However, only if all the additional conditions set out in Article 5(1) of the EU Regulation are met, a third country credit rating agency can be granted certification.

These conditions are that:

a) the credit rating agency is authorised or registered in and is subject to supervision in that third country;

b) cooperation arrangements are operational;

c) the credit ratings issued by the credit rating agency and its credit rating activities are not of systemic importance to the financial stability or integrity of the financial markets of one or more Member States.

Chapter II- Assessment of BRAZIL

Key to the references and terms used in this advice:

CRAs : Credit Rating Agencies
CVM : Comissão de Valores Mobiliários
COREMEC: Regulation and Audit Committee of the Financial, Capital, Insurance, Social Security, and Capitalization Markets.

Executive summary

Following ESMA's decision to consider the Brazilian regulatory regime as being in line with the requirements defined in Article 4(3) of the EU Regulation on CRA for the purpose of endorsement, this document sets out the technical advice of ESMA in relation to the equivalence between the Brazilian legal and supervisory framework and the EU regulatory regime for credit rating agencies, in accordance with the European Commission's mandate of 22 October 2012.

ESMA concludes that, overall, the Brazilian legal and supervisory framework is equivalent to the EU regulatory regime for credit rating agencies in terms of achieving what ESMA considers to be the overall objective of:

"assuring that users of ratings in the EU would benefit from equivalent protections in terms of the credit rating agencies integrity, transparency, good governance and reliability of the credit rating activities".

In coming to this conclusion, ESMA has verified whether the Brazilian legal and regulatory framework for Credit Rating Agencies met the requirements of the EU Regulation into seven areas[10], in relation to each of which ESMA has assessed the ability of the Brazilian legal and supervisory framework to achieve the main objectives of the relevant EU requirements. Nevertheless, a third-country CRA can only be granted "certification" if all the conditions set out in Article 5(1) of the EU Regulation are met, for example that the CRA is authorised or registered in and subject to supervision in that third country.

ESMA considers the Brazilian framework to be comprehensive and in many instances similar to the EU Regulation.

There are no areas where the Brazilian requirements do not meet the objectives of the EU requirements; there are no shortcomings, and as such ESMA has no recommendations to make in respect of the Brazilian legal and supervisory framework as a whole for the purposes of an equivalence determination by the European Commission.

ESMA will keep monitoring the evolution of the Brazilian legal and supervisory framework for credit rating agencies on an on-going basis, also via the cooperation agreements that the CVM and ESMA have signed in that field in April 2012 (ESMA/2012/274). It will update the European Commission in the event of future changes to the Brazilian regime that may necessitate a change in the conclusions of this report.

[10] These seven areas are:
1. The scope of the regulatory and supervisory framework
2. Corporate Governance
3. Conflicts of interest management
4. Organisational requirements
5. Quality of methodologies and quality of ratings
6. Disclosure
7. Effective supervision and enforcement.

Assessment of Brazil

109. This section of the report explains how ESMA assesses the equivalence between the Brazilian regulatory and supervisory framework and the EU regulatory regime for credit rating agencies.

110. This section is divided as follows:

a) The Brazilian legal and supervisory framework

b) The assessment of the equivalence on that framework to that of EU

111. This section outlines the general differences between the EU and the Brazilian approach on implementing the credit rating agency registration and oversight regime.

a) The Brazilian regulatory and supervisory framework

Overall philosophy of approach

112. On 22 December 2011 the Comissão de Valores Mobiliários - CVM (Securities and Exchange Commission of Brazil) published a public consultation on a proposal for a Rule regulating the credit rating activity in the Brazilian securities markets, on the basis of article 27 of the Law no. 6.385 of 1976. The proposed Rule focused on a number of requirements, namely registration and recognition of agencies, disclosure of information, conduct rules and internal controls.

113. The reasons for this decision were based on the widely discussed performance of credit rating agencies worldwide, and the number of international initiatives for regulating them around the world. Following the 2008 financial crisis which revealed several areas of weaknesses, the international community recognized the need to review the regulation of rating agencies, adopting two paths: (i) the elimination or reduction of the mandatory use of credit ratings for regulatory purposes; and (ii) the regulation of the credit rating agencies.

114. In Brazil, the Regulation and Audit Committee of the Financial, Capital, Insurance, Social Security, and Capitalization Markets – COREMEC created a working group with the aim to investigate possible paths so the Brazilian regulation might either reduce or eliminate the regulatory use of ratings. This work is still on-going.

115. The second measure adopted by CVM was the development of a regulation on the credit rating agencies. To this effect the European regulation, Regulation (CE) 1060, initially published on 2009, had a considerable influence on the elaboration of their Rule, especially due to its endorsability and equivalence regime, so that ratings issued by agencies outside the European Union could be used in Europe.

116. In addition, the CVM also took into consideration the regulation issued by the Securities and Exchange Commission - SEC (Rule 17g-1 to 17g-7), especially the provisions of the form NRSRO (Nationally Recognized Statistical Rating Organization).

117. The IOSCO Code of Conduct also has a prominent role in the Brazilian regulation, as CRAS are required to comply with each of its provisions, meaning that those issues not specifically provided by the CVM's Rules, are covered by the mandatory IOSCO provisions.

118. As a whole, since the adoption on 25 April 2012 of a specific Regulation on CRAs (Instruction CVM N° 521- ICVM 521-) the Brazilian regulatory and supervisory framework is very close to that of the EU Regulation in terms of the legal and supervisory framework that has been established for the

oversight of credit rating agencies.

119. The statutes and administrative regulations that specifically referred to CRAs are the Federal Law supporting the regulation, Law 6.385/76, and the new specific regulation ICVM 521.

Other parts of the securities law applying to CRAs would include insider trading and market manipulation.

b) The assessment of the equivalence between Brazil's framework and that of EU

120. On 24 April 2012 the CVM approved the final Regulation ICVM 521. Against this background, an assessment of the regulatory regime adopted in Brazil has been conducted. In carrying out that assessment, ESMA has verified its understanding of the relevant provisions through on-going informal contacts in particular with the CVM which acts as lead supervisor in Brazil.

121. The regime adopted in Brazil has been tested against the objectives pursued by the EU Regulation in the seven areas where it establishes requirements, which are identified in ESMA's Guidelines on Endorsement (ESMA/2011/139, Annex II). These areas are:

(I) the scope of the regulatory and supervisory framework;

(II) corporate governance;

(III) management of conflicts of interest;

(IV) organisational requirements;

(V) quality of methodologies and of ratings;

(VI) general disclosure and presentation of ratings;

(VII) effective supervision and enforcement.

122. As a background to this advice, on 27 April 2012 ESMA informed market participants that it considered that the recently adopted regulatory regime for CRAs in Brazil embedded requirements which followed closely those in place in the EU. As a consequence, the regulatory regime in Brazil was assessed as fulfilling the "as stringent as" test set out in Article 4(3) (b) of Regulation No 1060/2009 for the purpose of endorsement.

I. The scope of the regulatory and supervisory framework.

Definition of CRA and credit rating

123. According to the ICVM 521, a credit rating agency is a legal entity registered or recognized by CVM, that performs the activity of issuing credit ratings professionally within the scope of the securities market. The Rule does not apply to any other rated risk outside the securities market, nor private credit ratings related to financial assets which are not negotiated or publicly distributed in the securities market.

124. CVM has confirmed that ICVM 521 only confers them authority on the ratings related to the securities admitted to trading, however they also indicated that provided a CRA is registered within the scope of the ICVM 521, the CVM will be able to exert its supervisory powers on the activity and the conduct of any registered CRAs, and at the same time they will be empowered to request whatever information they consider necessary including on any rated risk different from the ones related to the securities. Furthermore, the CVM indicated that it believed it was not possible for CRAs to adopt their internal rules, procedures and manuals, only regarding their activity on the securities market, meaning that they consider they will also apply to the rest of the rated risk.

    CVM provided a letter confirming these interpretations.

    Notwithstanding the above, it seems that those ratings on instruments not admitted to trading would not be subject to enforcement by the CVM, however the divergence should not be very relevant bearing in mind that the access of EU investors to Brazilian securities not admitted to trading should be very limited. This last fact led ESMA to the conclusion that the main priority of assuring that users of Brazilian ratings in the EU benefit from equivalent protections in terms of CRA's integrity, transparency and reliability of the credit rating activity, should be covered.

Corporate form

125. Only corporations organized under the special provisions contained in the Brazilian Regulation, and in the General Law on Business Entities can apply for the provision of credit rating services. Authorisation to be registered requires CRAs to fulfil a number of requirements namely: (i) be established in Brazil; (ii) have the activity of credit rating as one of its business purposes; (iii) make a director responsible for the activities of the CRA, and another one responsible for the implementation and fulfilment of compliance with rules; and (iv) constitute and maintain human and technological resources adequate to the size and scope of its activity.

126. Credit rating agencies must have a code of conduct governing their activities, as well as the directors and personnel involved in the rating activity. The Brazilian Rule sets the minimum requirements to be met by credit rating agencies in their code of conduct in order ensure the independence and quality of ratings, and in addition, it establishes that this code must observe the fundamentals envisaged in the IOSCO Code.

Non-interference with ratings

127. The legal framework in Brazil does not contain an explicit legal prohibition for the CVM or other public authorities to influence the content of ratings and methodologies.

128. Additionally, there is no legal provision permitting public authorities to influence the content of rating or CRA methodologies. However, it is constitutionally ensured, by the lawfulness principle of Administrative Law that the entire public administration can only act if established by Law. Finally, CVM regulation deals exclusively with conduct rules and disclosure of information, not contemplating any public interference.

    To this regard, CVM indicated in their public consultation published on the 23rd of February that it will not interfere nor guarantee the content of the methodologies that have to be published by the CRAs. In addition, CVM has provided a letter confirming that the legal framework in Brazil does not allow it to influence the content of ratings and methodologies, and that CVM would not contemplate such interference.

129. It is also relevant to note that Brazilian Rules by requiring adherence to the IOSCO Code, force CRAs to comply with principle 2.1 that refers to the responsibility for CRAs not to forbear or refrain from taking a rating action based on the potential effect (economic, political, or otherwise) of the

action on the CRA, an issuer, an investor, or other market participant.

BRAZILIAN's SUPERVISORY AND REGULATORY FRAMEWORK FOR CRA	**BOX 1**

Brazil has a comprehensive and legally binding framework in relation to CRAs and the use of credit ratings. The Brazilian regime is in force since 2012 (all relevant laws and regulations for the equivalence assessment have entered into force). Six credit rating agencies are currently registered and supervised by the Comissão de Valores Mobiliários (CVM).

ESMA considers that both the EU and Brazilian regulatory and supervisory regimes for credit rating agencies share the same overall objectives namely, to ensure that CRA ratings are carried out fairly and from an independent standpoint

II. Corporate governance.

Corporate form

130. There is express requirement that a CRA shall be incorporated as a corporation and registered in the Federal Tax ID-CNPJ. Furthermore, CVM's Rules require that the application filed when requesting authorization to operate as a CRA, is accompanied with the information of the director responsible for the activities of the CRA, and another one responsible for the implementation and fulfilment of compliance with rules.

Director duties

131. The duties of directors and officers under the Corporations Act include that they must exercise their powers with the degree of care and diligence that a reasonable person would exercise, and in good faith in the best interests of the company. The responsibilities of the board would include inter alia overseeing the general strategy for the corporation's business; supervise the performance of the directors; examine the books and records of the corporation at any time, and take all other necessary action; give its opinion in advance on actions or contracts whenever required by the bylaws; give its opinion on the reports of the management and on the accounts of the board of directors. In general, Board members are responsible for and legally liable for any activity undertaken by the corporation.

    CRAs in Brazil are Limited Liability partnerships regulated by the Brazilian Civil Code (10.406/2002), not the Corporations Act (law. 6.404/1976), however there's a common practice to apply the Corporations Act provisions as supplementary rules whenever the Civil Code do not have the necessary standards.

132. Furthermore CVM's Rules establish in its Chapter II, Section I of Registration requirements that the CRA needs to fulfil some requirements, which include the mandatory appointment of a director responsible for the activities of the CRA, and another director responsible for compliance with rules, procedures and internal controls, which will have the specific task of monitoring the CRA activities and must exercise its function with independence.

Corporate governance structure

133. Pursuant to the CVM's Rules a CRA is required to have a corporate governance structure integrated by a minimum of two directors, one of them fulfilling the conditions for independence, and the regime provides rules on how administrative and monitoring functions are carried out by the CRA.

134. CVM's Rules require that the compliance director, which must fulfil the conditions for independence shall be competent for the following:

(i) the development and monitoring of the credit rating policy and of the methodologies used;

(ii) the effectiveness of any internal control system to ensure the compliance and inexistence of conflicts of interest.

(iii) the compliance and governance processes and the effectiveness of the criteria (methodologies) revision related functions.

135. Under the CVM's Rules, the conditions for independence clearly ensure that the compensation of the compliance director is not linked to the commercial performance of the CRA, and cannot take part in activities related to the issuing of credit ratings nor any commercial activity.

The monitoring functions

136. As previously indicated, under the Brazilian Regime there is a requirement to have at least one independent director (compliance director) that have to be assigned similar specific monitoring functions to the ones prescribed under the remit of the European regulation, in terms of reviewing and monitoring the development of the methodologies, the effectiveness of the internal control systems and of the methodologies review related functions.

a) Monitoring the development of credit rating policy and of the methodologies used by the credit rating agency in its credit rating activities

137. CVM's Rules impose obligations in relation to monitoring the development of rating methodologies encompassing namely: (i) use rigorous, systematic methodologies and, when possible, that result in credit ratings that can be verified objectively; and (ii) review, at least annually, the procedures and methodologies used to determine credit ratings. Furthermore, this function must be independent of the business lines that are responsible for the rating activities.

138. In addition, the Brazilian Rules, by imposing adherence to the IOSCO Code, require CRAS to observe obligations to (i) ensure that it has and devotes sufficient resources to carry out high-quality credit assessments of all obligations and issuers it rates; and (ii) to establish and implement a rigorous and formal review function responsible for periodically reviewing the methodologies and models and significant changes to the methodologies and models it uses.

139. The director in charge of the implementation and compliance with the rules (compliance director) will have the duty of monitoring the compliance and governance associated with the review functions.

b) Monitoring the effectiveness of the internal quality control system

140. The compliance director must submit to the CRA management, before the last business day of March, a report regarding the year ended prior to the date of such submission, containing: (i) the conclusions of the examinations carried out;(ii) the recommendations about any deficiencies, with the establishment of a schedule for resolving them, as applicable; and (iii) the statement by the rating agency's general manager, about the deficiencies found in the previous examinations and the measures planned, according to a specific schedule, or effectively adopted to correct them.

141. As indicated in a) above, Brazilian CRAs, by adherence to a code, must assign these tasks to a compliance director.

c) Monitoring of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated, managed and disclosed

142. This monitoring function required by regulation, provide that a compliance director, independent from the commercial and rating activities and with and compensation unrelated to the CRA performance, should be responsible, among other things: to identify and eliminate conflicts of interest. CVM's Rules require the establishment of internal control mechanism that allows the identification and elimination of any conflicts of interest that might influence the ratings, or may arise from other activities performed according to its social purpose. Compliance monitoring records must be kept.

d) Monitoring the compliance and governance processes

143. The Compliance director as identified above in a, b and c) has also the duty of monitoring the compliance and governance associated with the review functions.

Expertise by the board members in financial services and in structured finance products

144. CVM's Rules require CRAs to inform about the most relevant previous professional experiences of their Board of Directors members, within the last 5 years. Although there's no specific determination about what would be considered a sufficient expertise in financial services, the Brazilian authorities confirmed that as part of their on-going supervision practices they will be checking the adequacy of the members appointed to these positions.

CORPORATE GOVERNANCE	**BOX 2**
ESMA considers that, overall the Brazilian legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to corporate governance. Corporate Governance is mainly achieved through the appointment of at least one executive director and other one responsible for compliance, which must fulfil the condition s for independence.	

III. Conflicts of interest management

145. CRAs must have in place adequate arrangements for the management of conflicts of interest that arise in their business. CRAs' code of conduct must provide for the adoption of mechanisms to identify, eliminate, manage and disclose situations involving conflicts of interest in carrying out the credit rating activity.

146. In addition to that, the agency's code of conduct must observe the Code of Conduct Fundamentals for Credit Rating Agencies from IOSCO, which require CRAs to be organised in a manner that ensures its business interest does not impair the independence and accuracy of its credit rating activities.

147. The credit rating agency's code must provide for the independence of the rating agency, the credit rating analysts and that of the other individuals involved in the credit rating process, including the

compensation policy and the segregation of the activities. To this regard, the CRA must organize its activities in a way in which the agency is able to manage or eliminate eventual conflicts of interest that may affect the impartiality of ratings and of rating analysts. In addition, CVM's Rules also establish that when a conflict is identified, the CRAs must inform the rated entity of the fact and the sources of this conflict, before providing the credit rating.

148. Disclosure to the public has to be done in the rating report which must publicly disclose any potential non prohibited conflict of interest related to the CRA. The Brazilian Rules establish a non-exhausted list of situations that would be considered a potential conflict of interest and a number of conflicting situation s that would be prohibited.

Disclosure of names of main rated entities

149. CVM's Rules require CRAs to identify entities rated or related third parties accounting for more than 5% of its annual revenue, as part of the Reference Form that must be updated on an annual basis and maintained in the CRAs' internet website. This situation must also be informed in the rating report.

Ownership of financial instruments

150. Section II of Chapter IV of the Brazilian Rules establish a number of prohibitions related to the issuance of credit ratings in cases where

a) the agency, the credit rating analysts or other individuals involved in the credit rating process have, directly or indirectly, financial assets of the entity which is being rated or of any related third party.

b) this does not apply to participations on investment funds, except if the agency, rating analysts or related third party can influence, directly or indirectly, the management of the fund, or if the fund concentrate its investments in sectors or companies covered by the rating elaborated by the agency;

c) the rated entity or related third party is directly or indirectly part of the controlling block of the credit rating agency;

d) the credit rating analysts or the other individuals involved in the credit rating process are members of the Board or have decision power at the rated entity;

e) the credit rating analysts or other individuals involved in the credit rating process have had any type of relation with the rated entity or with a related third party, which can cause a conflict of interest.

151. In addition, Brazilian CRAs are also required to abide by the provisions of the IOSCO Code that prevent employees participating in or influencing a rating where they own securities or derivatives of the rated entity or where they have had a relationship with a rated entity or related party. The IOSCO Code also provides that the disclosure of actual and potential conflicts of interest should be complete, timely, clear, concise, specific and prominent.

Rotation of rating analysts and persons approving credit ratings

152. CVM's Rules envisages the possibility for CRAS to organize its activities so that they can promote the rotation of the credit rating analysts. In this case, the Brazilian Rules would also require including a description of the policy for rotation of analyst in the annual reference form that has to be disclosed to the public.

Consultancy or advisory services

153. CVM's Rules prohibits CRAs from providing to the rated entity or related third party consultancy or any other service able to compromise the independence of the CRA.

154. In addition to that, according to what is provided by the IOSCO Code, CRAs and their analysts are prevented from making proposals or recommendations regarding the design of structured finance products that a CRA rates. On the other hand, although the IOSCO Code does not explicitly ban CRAs from providing consultancy or advisory services, it provides that they must have adequate arrangements in place to manage any conflicts of interest that arise in its business.

Involvement of rating analysts in the negotiation of fees and compensation.

155. Brazilian Rules prohibit rating analysts or anyone involved in the process of issuing credit ratings from participating in the negotiation of the terms of the credit rating contract.

156. In addition, Brazilian CRAs must abide by a code of conduct that prohibits a CRA from involving their technical staff in activities related to the collection of fees or payments owed by the rated entities or by any company belonging to the group of the rated entity.

157. CVM's Rules also establish that compensation and performance evaluation of the credit rating analysts and the other individuals involved in the credit rating process should not be contingent on the amount of revenue that the CRA derives from the rated entities or related third parties.

Ancillary services

158. In addition to the general obligation of adopting mechanisms to identify, eliminate, manage and disclose situations involving conflicts of interest in carrying out credit rating activities, the Brazilian Regulation imposes CRAs to ensure complete segregation of the rating activities and the other tasks performed by the agency or by related parties, adopting operational procedures aiming to physically segregate the facilities between the areas responsible for different activities performed.

CVM also establish disclosure requirements in the rating report, which must include other services provided to the rated entity by the CRA or parties related to rating agency over the last 12 months.

CONFLICTS OF INTEREST MANAGEMENT **BOX 3**

ESMA considers that, overall, the Brazilian legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to conflicts of interest management, and points out that the framework includes provisions which are similar in their large majority to those of the EU Regulation.

Conflicts of interest management is dealt with through the application of the requirements imposed in Brazilian Rules and the mandatory observance of the IOSCO Code.

Finally, with regard to the establishment of a rotation mechanism for rating analysts, although this provision is not mandatory under the Brazilian Regulation, ESMA considers that, as a whole, the Brazilian framework meets the same objectives as the EU Regulation.

IV. Organisational requirements

159. The credit rating agency's code of conduct must provide for the adoption of a number policies and procedures in order to ensure compliance with the Regulation. To this regard, it must contain among others, procedures that ensure the quality and independence of the credit rating assignment process, the periodic monitoring of ratings, the compensation policy and the segregation of the activities, the adoption of mechanisms to identify, eliminate, manage and disclose situations involving conflicts of interest, the policy for negotiating the terms and conditions of contracts with rated entities and the adoption of a policy for trading of securities by rating analysts and other persons involved in the rating process. It must also have file maintenance procedures, related to the internal control policy.

160. CVM requires applicants to demonstrate as part of the registration process and as an on-going obligation, that they have the organisational competence to provide rating services. CRAs must disclose in their application their administrative and operational structure designed to ensure compliance.

    To this regard, the CRA have to describe the agency's administrative structure, as established in its articles of association or bylaws and internal rules, detailing: (i) abilities of each body and committee; (ii) individual faculties and abilities of the directors; (iii) information on the requirements for carrying out activity as credit rating analyst; and (iv) information about the minimum qualification required for credit rating analysts and other individuals taking part in the credit rating process.

161. With regard to the obligation of maintaining a permanent compliance function, as previously indicated, this would be under the remit of the director responsible for the implementation and effectiveness of compliance, who shall do this independently. To this regard the director for compliance must not act in functions related to credit rating or any other commercial activity, and its remuneration may not be linked to the commercial performance of the CRA.

162. The compliance director would also be in charge of the monitoring of the internal control mechanisms and its effectiveness, and he would be required to submit to the CRA management, before the last business day of March, an annual report, containing: (i) the conclusions of the examinations carried out;(ii) the recommendations about any deficiencies, with the establishment of a schedule for resolving them, as applicable; and (iii) the statement by the rating agency's general manager, about the deficiencies found in the previous examinations and the measures planned, according to a specific schedule, or effectively adopted to correct them.

163. With regard to the resources devoted to the continuity and regularity on the performance of CRA's credit rating activities and their on-going monitoring, the CRA must maintain adequate human and technical resources according to its size and area of activity. The technical resources must be protected against forgery or fraud, and the system must maintain records which allow for auditing and inspections. The code of conduct of the CRA shall provide for the regularity of the monitoring of the credit-risk ratings.

Outsourcing

164. Under the Brazilian Rules the outsourcing of relevant operational functions is not allowed if it affects substantially (i) the quality of internal controls of the CRA, and (ii) the supervision of the fulfilment of obligations related to this regulation.

Confidentiality

165. Rating agencies must have internal control manuals that set forth policies for the adequate monitoring of confidential information. To this regard, CVM's Rules provide that the CRAs code of conduct must refer to the treatment of confidential information.

Brazilian CRAs are bound to have control over the confidential information that its directors, employees and collaborators have. Besides, there must be a total segregation between the activity of credit rating and any other activity developed by the agency, leading to the preservation of the confidential information by all that are involved in the process of credit rating, the restriction of access to files, as well as the adoption of controls limiting the access and permitting the identification of those who have access to confidential information.

166. In addition, CVM's Rules, by requiring adherence to the provisions of the IOSCO Code, require a CRA to protect confidential information and issuer's property from abuse.

Record keeping

167. Brazilian CRAs must maintain, for a minimum period of 5 years, or for a longer term, if determined by CVM in case of an enforcement procedure, all documents and information required by the relevant Rule, as well as all mailing, reports, and works related to the exercise of rating activities. All these documents can be safeguarded by physical or electronic means, admitting the substitution of the documents by the corresponding digital image.

ORGANISATIONAL REQUIREMENTS	**BOX 4**
ESMA considers that, overall, the Brazilian legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to organisational requirements, including outsourcing, record keeping and confidentiality.	

V. Quality of methodologies and quality of ratings

168. Brazilian CRAs must have a review function, independent from the business lines, responsible for periodically reviewing its methodologies and reporting to the members of the board.

In addition, CVM's Rules assign to the compliance director the specific responsibility of reviewing and monitoring the developments of this review function, as well as the effectiveness of these methodologies review related functions.

169. Models and key rating assumptions must be examined by the required review function, although they are not specified as separate items, since they are considered as an intrinsic part of the methodology. The review of models and key rating assumptions are then part of the tasks of review function.

170. Brazilian CRAs are also required to review ratings on a regular and periodic basis, except for those cases which clearly indicate not entailing continuous monitoring. This obligation will include the regular monitoring of the credit status of the evaluated organizations, the revision of the rating after becoming aware of any information that may result in a rating action, and the prompt update of the

classification, following the review.

Periodicity of the review

171. The Brazilian Regulation requires CRAs to periodically monitor and review their procedures and methodologies, at least on an annual basis.

12-hour rule

172. There is no such provision in the Brazilian Rules, however, CVM's Rules, by requiring adherence to provision of the IOSCO Code, require CRAs to inform the issuer of the critical information and principal considerations upon which the rating will be based, to afford the issuer an opportunity to clarify any misperceptions or other matters. Where feasible and appropriate, this information must be given before publishing the rating.

173. In addition, CRAs must disclose in its rating reports if the rating was previously communicated to the issuer or its related parties related to it, and if, as a result of this, the rating attributed was altered before the report was issued.

Minimum quality of information

174. The credit rating reports must be prepared strictly following the procedures and methodologies adopted by the agency. To this regard CVM's Rules establish that the CRA code of conduct must provide for: i) the adoption of procedures that ensure the quality of the credit rating assignment process; and ii) the commitment to search for adequate and reliable information to be used in the elaboration of its credit ratings.

In cases where the lack of reliable data or the complexity of the structure of a new type of financial instrument raises serious questions as to whether the credit rating agency can produce a credible credit rating, the credit rating agency is prohibited to issue a credit rating or to continue its monitoring.

175. CMV Rules approach follows the IOSCO code of conduct provisions, which require a CRA to: (i) assess whether its analysts will have access to sufficient information to rate or continue to rate an obligation or issuer; and (ii) to refrain from issuing a rating where there are serious questions about whether the CRA can determine a rating in light of the complexity or structure of a new product or a lack of robust data about the assets underlying a structured product.

Dynamic assessment of methodologies

176. CRAs are required to use rating methodologies that are rigorous, systematic, and, when possible, lead to credit ratings that can be objectively verified. The requirement does not include that the methodology is continuous.

177. Following CVM's Rules, CRAs should consider consistent and verifiable information in their methodologies, with the aim of enabling the understanding and use of ratings by third parties, by making them able to verify if the said methodology was used or not.

Changes in methodologies and model

178. In the case of significant changes in the methodologies and procedures used to elaborate the ratings, the agency must (i) immediately disclose, in the media used to publicize the credit rating, the potential impact in the ratings elaborated by the agency; and (ii) review all ratings based on those methodologies and procedures, in less than 6 months.

QUALITY OF METHODOLOGIES AND QUALITY OF RATINGS	**BOX 5**
ESMA considers that, overall, the Brazilian legal and supervisory framework does achieve the objectives of the EU regulatory requirements in relation to the quality of methodologies and quality of ratings. ESMA understands that CRAs in Brazil are required to periodically review their ratings, methodologies and models; where there has been a material change to the methodology, all affected ratings must be reviewed within 6 months of the change.	

VI. General disclosure and presentation of ratings

(a) Disclosure of credit ratings

Timely and non-selective disclosure

179. CVM's Rules, by requiring adherence to the provision of the IOSCO Code, require CRAs to distribute in a timely manner its ratings decisions regarding the entities and securities it rates. It also requires updating on a timely basis the rating, as appropriate, based on the results of the periodic review.

    The CRA must also send to the CVM eventual information related to the decision to discontinue a credit rating, and CVM can request information regarding the reasons for such a decision.

180. The CRA must keep in the internet a webpage, where it must disclose the reports on credit ratings elaborated, including the preliminary opinions given as preliminary consultation or request for analysis. This information must be also disclosed through CVM's internet site.

Unsolicited ratings

181. Regarding ratings which have not been solicited by the rated entity or related third party, Brazilian Rules provide that this fact must be disclosed in the report. The CRA must describe the internal control policy identifying unsolicited credit ratings disclosure policy.

182. The CVM's Rules do not explicitly mention the obligation to disclose if the rated entity participated in the rating process, however the Brazilian Rules by requiring adherence to the IOSCO code requires CRAs to disclose whether the issuer participated in the rating process. Each rating not initiated at the request of the issuer should be identified as such. A CRA should also disclose its policies and procedures regarding unsolicited ratings.

Historical performance of ratings

183. Brazilian CRAs must elaborate a document, based on the historical performance of the ratings since 2002, broken down by segment, in order to demonstrate the probability of a rated entity, a structured operation, a financial obligation or any other financial asset with a determined rating, become default in the period of 1 and 3 years. Furthermore, the Reference Form that must be published on an annual basis must also contain the default rate matrices.

Material sources

184. Several provisions in the Brazilian Regulation require information about how the rating was reached, which methodology was used and any key elements underlying the rating opinion. Considered together they have the same net outcome as a requirement to indicate all material sources used to prepare a credit rating.

Release date and update of credit ratings

185. CVM's Rules establish that the rating report must disclose the date at which the credit rating was released by the first time and the last time it was updated.

Disclosure of quality of information used in the rating process

186. The Brazilian Regulation require CRAs to disclose (i) the sources of information used to determine a rating, included those provided by third parties; ii) the facts and circumstances in which the decision was based on and; (iii) the attributes and eventual limitations of the credit ratings released, in relation to extension, quality and veracity of documents and historical data.

187. There is a specific prohibition for rating agencies to issue or monitor a credit rating if they are not satisfied with the quality of the information on which to base the rating.

This prohibition is also supported by the fact that, CVM by requiring adherence to the IOSCO code provisions, require CRAs to: (i) assess whether its analysts will have access to sufficient information to rate or continue to rate an obligation or issuer; and (ii) to refrain from issuing a rating where there are serious questions about whether the CRA can determine a rating in light of the complexity or structure of a new product or a lack of robust data about the assets underlying a structured product.

188. Following what is stated in the Brazilian Rules and the IOSCO Code provisions mentioned above, a CRA will not be able to issue or monitor a credit rating if it is not satisfied with the quality of the information on which it has based the rating. Therefore, there is no need for any specific requirement for a CRA to indicate its view of the quality of the information on which it bases its credit rating, it should always be satisfied that it has enough information for high quality ratings. To this regard, if a CRA were to issue a rating where it does not have sufficient quality of information on which to base its rating, the CRA may breach the Brazilian Rules.

Disclosure of information on structured finance ratings

189. The Brazilian Regulation requires a CRA (i) to provide sufficient information about its loss and cash flow analysis for a structured finance product it has performed or is relying upon; ii) the possible changes in the credit rating and ; (ii) the level of assessment concerning the due diligence processes carried out at the level of underlying assets.

190. These provisions meet the objectives of the EU requirement, namely sufficient information to enable investors to understand the basis for the rating and to provide information on potential changes to the rating assumptions.

(b) Disclosure concerning the credit rating agency and its activities.

Public register of CRAs

191. No entity is able to provide credit ratings in Brazil unless they are registered as a credit agency. CVM is required to maintain a register of registered CRAs which is accessible to the public.

Furthermore, the register form of all credit rating agencies shall be disclosed at the webpage of the CVM.

Ancillary services

192. Brazilian CRAs have the obligation to send to the CVM and disclose to the general public a reference form on an annual basis, by March 31st each year, containing inter alia other services provided by the rating agency or parties related to it, over the last 12 months.

Compensation arrangements

193. Under the Brazilian Regulation a CRA must disclose an annual reference form indicating the products and services commercialized, the amount of issuers and structured finance and financial operations carried out, and the percentage of the agency's net profit originated from each segment.

194. Brazilian CRAs must identify the entities rated or parties related to them, accounting for more than 5% (five per cent) of the agency's net annual revenues, informing the total amount of revenues generated by the agency. The report on credit rating shall demonstrate any situation that can be considered a potential conflict of interest, and one these situations is precisely cases where the rated entity or related third party is responsible for more than 5% of the CRA's annual revenue.

Other items subject to disclosure

195. Brazilian CRAs must keep an internet webpage containing: (i) the annual reference form; (ii) the code of conduct; (iii) compliance measures; (iv) report on the credit ratings elaborated, including the preliminary opinions given as preliminary consultation or request for analysis.

Periodical disclosure

196. CVM requires CRAs to elaborate a document, based on the historical performance of the ratings since 2002, broken down by segment so as to evidence:

a) the initial credit ratings, their changes and the probability of transition, for each rating, within a term of 1 and 3 years (credit rating transition matrix); and

b) the probability of an issuer, a structured operation, a financial obligation or any other rated financial asset with a specific rating default within one and three years (default rate matrix).

In case of a CRA that is part of a group with operations in other jurisdictions, it must also submit the matrices with the global market information in the period of 1 and 3 years.

197. Significant changes to the methodologies, procedures and criteria used in the assigning of the credit rating, must be disclosed on the CRAs' website and also be sent to the CVM through an electronic system available on the CVM's public website.

Annual disclosure

198. CRAs have to make public an annual report including, among other information, a description of its legal structure, scope of activities, selected financial information, the internal control mechanisms, details of its record management procedures, the procedures and methodologies used to assign

credit ratings, changes to its code of conduct, a statistical report on its ratings performance, statistics on staff allocation to analytical activity (both detailing senior and junior analyst, and breakdown per groups based on the activity carried out), analyst and managers rotation policy if applicable, functions and procedures related to compliance and internal auditing.

The outcome of the assessment of effectiveness of the CRAs' internal controls carried out by the compliance function is only made available to CVM on request. Following ESMA's guidelines on the application of the endorsement, disclosure to the authority has been considered appropriate for the purposes of establishing equivalence.

DISCLOSURE OF RATINGS **BOX 6**

There are two distinct types of disclosure requirements in the EU Regulation: (i) those relating to the disclosure that a credit rating agency needs to make on a rating-by-rating basis, and (ii) those relating to the credit rating agency itself.

(a) Disclosure of credit ratings

ESMA considers that the Brazilian legal and supervisory framework, overall, does achieve the objectives of the EU requirements that relate to disclosure of credit ratings.

(b) Disclosure concerning the credit rating agency and its activities

ESMA considers that, the Brazilian legal and supervisory framework, overall, achieves the objectives of the EU requirements that relate to disclosure regarding the credit rating agency and its activities.

VII. Effective supervision and enforcement

199. Under the Brazilian Law, the CVM is responsible for the observance of the following objectives:

- to assure the proper functioning of the exchange and over-the-counter markets;
- to protect all securities holders against fraudulent issues and illegal actions performed by company managers, controlling shareholders, or mutual fund managers;
- to avoid or inhibit any kind of fraud or manipulation which may give rise to artificial price formation in the securities market;
- to assure public access to all relevant information about the securities traded and the companies which have issued them;
- to ensure that all market participants adopt fair trading practices;
- to stimulate the formation of savings and their investment in securities; and
- to promote the expansion and efficiency of the securities market and the capitalization of Brazilian publicly held companies.

Powers of the relevant authority

200. The Law empowers the CVM to investigate, judge, and punish any irregularity that might occur in the securities market. In the event of any suspicious activities, the CVM may initiate an administrative inquiry to collect information, formal statements, and material evidence aiming at the identification of responsibility related to any kind of illegal practices.

201. The CVM employs qualified professionals, who are responsible for providing advisory support to investor and for receiving suggestions and complaints related to market practices.

202. CVM has the following powers in respect of their CRA supervisory responsibilities:

- The CVM may examine and extract examples of accounting records, books or documents, including electronic programs, magnetic and optical files, as well as any other files, including work papers of independent auditors. All of them have to be organized and maintained for at least 5 (five) years.
- The CVM may request information or clarifications under penalty of a fine, without prejudice to other penalties.
- The Brazilian Commission shall permanently control the activities and services of the securities market, so it can conduct inspections with or without announcement.
- The CVM may require that market participants hold recording system of all dialogues with their customers, in order to record conversations held by telephone or other means of communication. In these cases, CVM can obtain copies of the transcription of the dialogues or files maintained by the market participant.
- The CVM, upon request, may also take part in legal disputes involving the securities market. Its activities can range from the collection of evidence to the issuance of legal opinions. In those cases, it acts as "amicus curiae" assisting the Judiciary.

203. The CVM is empowered to impose a number of penalties to credit rating agencies and anyone involved in the rating process directly, ranging from warning and fines to de-registration and suspensions (up to 20 years). Should the CVM verify that a crime has been committed, it must refer the matter to the Public Attorney's Office ("Ministério Público").

The penalties are published in the Official Journal and are available for consultation on the CVM website.

204. Article 11 of Federal Law no. 6.385/76 establishes that the Brazilian Commission may impose fines following infringements of any requirements of the referred law, the Corporation Law, or its resolutions, as well as any other legal provisions under CVM's responsibility. The Fines imposed shall not exceed the larger of :

I - R$ 500,000.00 (five hundred thousand Brazilian Reais);

II - 50 per cent of the amount of the securities issuing or of the irregular operation;

III - three times the amount of the economic advantage gained or loss avoided due to the violation.

If the offense is repeated, the fines can be multiplied up to three times.

205. In addition, Chapter VIII of CVM's Rules establish that CRAs will be subject to a daily fine as a result of breach of the deadlines foreseen for the delivery of periodic information, at a value of R$ 500.00 (five hundred Brazilian Reais), and that the breach of what is displayed in their articles. 19, 20, 22, 25, 28, 29, 31 & 32 will be considered a serious infraction.

206. CVM may also enter into arrangements with other bodies to facilitate cooperation between regulators in performing supervisory and investigative functions. For example, memoranda of understanding between CVM and other regulatory bodies typically set out the parties' intent to cooperate with each other in executing the laws and regulations applicable in the respective jurisdictions in relation to the discharge of their responsibilities in relation to regulated entities.

EFFECTIVE SUPERVISION AND ENFORCEMENT	**BOX 7**
ESMA considers that the Brazilian legal and supervisory framework ensures that the CVM is entrusted with sufficient powers to enable effective supervision and enforcement over credit rating agencies.	

c) Conclusion on the equivalence status regarding the Brazilian legislative and regulatory framework

GLOBAL ASSESSMENT	**BOX 8**
ESMA concludes that overall the Brazilian legal and supervisory framework is equivalent to the EU regulatory regime for CRA in terms of what ESMA considers to be overall objective of: "assuring that users of ratings in the EU would benefit from equivalent protections in terms of the CRAs integrity, transparency, good governance and reliability of the credit rating activities" However, only if all the other conditions set out in Article 5(1) of the EU Regulation are met, can a third country credit rating agency be granted certification. These conditions are that: -the credit rating agency is authorised or registered in and is subject to supervision in that third country; -cooperation arrangements are operational; -the credit ratings issued by the credit rating agency and its credit rating activities are not of systemic importance to the financial stability or integrity of the financial markets of one or more Member States.	

Chapter III. Assessment of MEXICO

Key to the references and terms used in this advice:

CRAs: Credit Rating Agencies

CNBV: Comisión Nacional Bancaria y de Valores

Executive summary

Following ESMA's decision to consider the Mexican regulatory regime as being in line with the requirements defined in Article 4(3) of the EU Regulation on CRA for the purpose of endorsement, this document sets out the technical advice of ESMA in relation to the equivalence between the Mexican legal and supervisory framework and the EU regulatory regime for credit rating agencies, in accordance with the European Commission's mandate of 22 October 2012.

ESMA concludes that, overall, the Mexican legal and supervisory framework is equivalent to the EU regulatory regime for credit rating agencies in terms of achieving what ESMA considers to be the overall objective of:

"assuring that users of ratings in the EU would benefit from equivalent protections in terms of the credit rating agencies integrity, transparency, good governance and reliability of the credit rating activities".

In coming to this conclusion, ESMA has verified whether the Mexican legal and regulatory framework for Credit Rating Agencies met the requirements of the EU Regulation into seven areas[11], in relation to each of which ESMA has assessed the ability of the Mexican legal and supervisory framework to achieve the main objectives of the relevant EU requirements. Nevertheless, a third-country CRA can only be granted "certification" if all the conditions set out in Article 5(1) of the EU Regulation are met, for example that the CRA is authorised or registered in and subject to supervision in that third country.

ESMA considers the Mexican framework to be comprehensive and in many instances similar to the EU Regulation.

There are no areas where the Mexican requirements do not meet the objectives of the EU requirements, and as such ESMA has no recommendations to make in respect of the Mexican legal and supervisory framework as a whole for the purposes of an equivalence determination by the European Commission.

ESMA will keep monitoring the evolution of the Mexican legal and supervisory framework for credit rating agencies on an on-going basis, also via the cooperation agreements that the CNBV and ESMA have signed in that field in March 2012 (ESMA/2012/256). It will update the European Commission in the event of future changes to the Mexican regime that may necessitate a change in the conclusions of this report.

[11] These seven areas are:
1. The scope of the regulatory and supervisory framework
2. Corporate Governance
3. Conflicts of interest management
4. Organisational requirements
5. Quality of methodologies and quality of ratings
6. Disclosure
7. Effective supervision and enforcement.

Assessment of Mexico

207. This section of the report explains how ESMA assesses the equivalence between the Mexican regulatory and supervisory framework and the EU regulatory regime for credit rating agencies.

208. This section is divided as follows:

a) The Mexican legal and supervisory framework.

b) The assessment of the equivalence between that framework and that of the EU.

209. This section outlines the general differences between the EU and the Mexican approach on implementing the credit rating agency registration and oversight regime.

a) The Mexican regulatory and supervisory framework

Overall philosophy of approach

210. As a whole, since the adoption on 17/02/12 of the amendment of its applicable Regulation on CRAs (Disposiciones Aplicables a las Instituciones Calificadoras de Valores) the Mexican legislative and regulatory framework is very close to that of the EU Regulation, in terms of the legal and supervisory framework that has been established for the oversight of credit rating agencies.

211. In Mexico, CRAs have been regulated and supervised by the Mexican Banking and Securities Commission (Comisión Nacional Bancaria y de Valores hereinafter referred as the "CNBV") since July of 1993. Authorization of CRAs has been required since the December 1999 enactment of the Regulation for CRAs, which included, among other things, requirements to obtain authorization to operate as a CRA, requirements to maintain internal controls for the rating process, and qualification requirements for analysts. In 2005, the Mexican Congress amended the Securities Market Law (SML) in order to empower the CNBV to enact conduct rules for CRAs. The rules adopted that same year by the Mexican Commission incorporated the principles set forth in the IOSCO CRA Code.

212. The regulatory and supervisory framework may be divided into: (i) statutes and administrative regulations specifically referred to CRAs; and (ii) supplemental statutes and administrative regulations applicable to CRAs.

The statutes and administrative regulations specifically referred to CRAs are: (i) Chapter II of Title XI of Mexico's Securities Act (Ley del Mercado de Valores), and (ii) the Rules Applicable to CRAs (Disposiciones Aplicables a las Instituciones Calificadoras de Valores), issued by CNBV

Other parts of financial services laws applying to CRAs would include: insider trading and market manipulation.

b) The assessment of the equivalence between Mexico's framework and that of EU

213. On 17 February 2012 the CNBV published in its official journal the final amended Rules. Against this background, an assessment of the regulatory regime adopted in Mexico has been conducted.

In carrying out that assessment, ESMA has verified its understanding of the relevant provisions

through on-going informal contacts in particular with the CNBV which acts as lead supervisor in Mexico.

214. The regime adopted in Mexico has been tested against the objectives pursued by the EU Regulation in the seven areas where it establishes requirements, which are identified in ESMA's Guidelines on Endorsement (ESMA/2011/139, Annex II). These areas are:

(I) the scope of the regulatory and supervisory framework;

(II) corporate governance;

(III) management of conflicts of interest;

(IV) organisational requirements;

(V) quality of methodologies and of ratings;

(VI) general disclosure and presentation of ratings;

(VII) effective supervision and enforcement.

215. As a background to this advice, on 18 April 2012 ESMA informed market participants that it considered that the recently adopted regulatory regime for CRAs in Mexico embedded requirements which followed closely those in place in the EU. As a consequence, the regulatory regime in Mexico was assessed as fulfilling the "as stringent as" test set out in Article 4(3) (b) of Regulation No 1060/2009 for the purpose of endorsement.

I. The scope of the regulatory and supervisory framework.

Definition of CRA and credit rating

216. The Securities Act establishes that the provision of rating services is exclusively entitled to credit rating agencies. CRAs have to be previously authorised by the CNBV in order to operate and provide credit rating services. The Rules Applicable to CRAs set forth that these are the legal persons whose corporate purpose consists in performing credit rating services on a customary and professional basis.

217. Article 334 of the Securities Act defines the rating activity as providing regular and professional services in the study, analysis, opinion, evaluation and feedback on the credit quality of securities, in terms of Stock Market Law.

Corporate form

218. Only corporations organized under the special provisions contained in the Mexican Act, and in the General Law on Business Entities can apply for the provision of credit rating services. These authorisations to operate as a rating agency shall not be transferable because of their nature.

Authorisation regime

219. The general obligations that apply to all credit rating agencies under the Mexican regime, require to have (inter alia): (i) Internal manuals, containing at least, delineation of responsibilities of each area, description of the rating process, and internal control mechanisms, providing among others, the identification and elimination of conflicts of interest, operational separation, and protection of confidential information; (ii) a general operating program including the basics for the organization, together with a description of the infrastructure of information systems, (iii) a description of the technical staff responsible for the development and follow-up of opinions on the creditworthiness of the securities or entities, as well as, the documentation proving the technical experience of the same; (iv) a code of conduct regulating the performance of the rating agency, so that its services are provided efficiently, honestly and fairly.

220. Credit rating agencies must have a code of conduct governing their performance as well as of the Directors and personnel involved in the rating activity. The Mexican Securities Act establishes that this code must meet international standards and it delegates to the Mexican National Banking and Securities Commission, setting the minimum requirements to be met by credit rating agencies in their code of conduct. To this regard CNBV has incorporated in its Rules the principles envisaged in the IOSCO Code.

Non-interference with ratings

221. Although there is no specific prohibition in the Law, the CNBV is not allowed to influence the content of ratings or CRA methodologies. To this regard, CNBV provided a letter confirming that neither in the regulation, nor in the supervision, it is envisaged any interference with the methodologies. According to CNBV, the Mexican Regulation only provides for a minimum number of requirements that such methodologies should meet when they are applied, but in any case, it is exclusively up to the CRAs to decide what to consider.

222. In addition to that, there is a Civil Right that establishes that administrative authorities (such as the CNBV) are only allowed to act when they have an express authority/power set forth under applicable law. Such Civil Right is generally set forth under Sections 14 and 16 of the Mexican Constitution (Constitución Política de los Estados Unidos Mexicanos) and is recognized by the Mexican Courts.

MEXICAN SUPERVISORY AND REGULATORY FRAMEWORK FOR CRA **BOX 1**

Mexico has a comprehensive and legally binding framework in relation to CRAs and the use of credit ratings. The Mexican regime is in force since 1993 (all relevant laws and regulations for the equivalence assessment have entered into force). Five credit rating agencies are currently registered and supervised by the Comisión Nacional Bancaria y de Valores (CNBV).

ESMA considers that both the EU and Mexican regulatory and supervisory regimes for credit rating agencies share the same overall objectives namely, to ensure that CRA ratings are carried out fairly and from an independent standpoint

II. Corporate governance.

Corporate form

223. There is express requirement that a CRA shall be incorporated as a corporation as provided under Mexico's General Law on Business Entities. Furthermore, the Securities Act requires that the application filed with the CNBV, when requesting authorization to operate as a CRA, is accompanied with the information of: (i) members of the board of directors, (ii) CEO (director general), and (iii) principal officers.

Director duties

224. A Mexican corporation is required to have directors. The duties of directors and officers under the Corporations Act include the obligation to exercise their powers with the degree of care and diligence that a reasonable person would exercise and in good faith in the best interests of the company. The responsibilities of a board envisaged in the Corporations Act include overseeing the existence and maintenance of company accountability systems, internal controls, recording obligations and legal and statutory compliance. In general, Board members are responsible for and legally liable for any activity undertaken by the corporation.

225. Furthermore CNBV's Rules establish in its section VI the responsibilities of a CRA Board of Directors, envisaging among others, the approval of policies that set up their functions and responsibilities, the remuneration system for the personnel participating in the rating process, the rotation of the committees or technical staff devoted to rating activity, and the structure and voting process of the committees responsible for the determination and monitoring of the ratings

    The Board of Directors will also be responsible of approving methodologies.

Corporate governance structure

226. Mexican corporations need to have a corporate governance structure in place. Under the Mexican legislation a CRA is required to have a board of directors, and the regime provides stringent rules on how administrative and supervisory functions are carried out by the CRA.

227. The composition of the Board of Directors of a CRA, is regulated[12] in article 24 of the Mexican Securities Market Law that applies for all issuers, and shall consist of a maximum of twenty-one directors, of which at least twenty-five per cent must meet the requirements for independence.

    The requirements to be considered independent are also based on article 26 of the Securities Market Law which applies as benchmark for CRAs. Independent directors must be determined by resolution of the General Shareholders Meeting, and in no case they should be appointed from:

    - executive officers or employees of the CRA or affiliate
    - individuals with significant influence or in the CRA or business group to which it belongs or shareholders who maintain control of the CRA.
    - customers, service providers, suppliers, debtors, creditors, or partners, directors or employees of these third parties.

[12] This means that the Mexican authority applies this requirement to CRAs seeking approval to issue ratings

- any other relationships that could be reasonably expected to interfere with the exercise of a director's independent judgment

CNBV may object to the quality of independence of Board Members, when there are elements that demonstrate the lack of independence as provided by Law.

228. The code of conduct requires that, where appointed, independent directors shall be competent for the following:

- the development and monitoring of the credit rating policy and of the methodologies used;
- the effectiveness of the internal control system to ensure the compliance and inexistence of conflicts of interest.
- the compliance and governance processes and the effectiveness of the criteria (methodologies) revision related functions.

Where the CRAs do not have independent directors designated, they shall assign the above-mentioned competencies to an officer or area which is independent from the general management and reports directly to the board of directors.

229. Furthermore, the requirements clearly ensure that the compensation of the independent members of the administrative board is not linked to the level of revenues obtained by the rating agency.

<u>The monitoring functions</u>

230. As indicated in the previous section, under the Mexican Regime there is a requirement to have independent directors that have to be assigned similar specific monitoring functions to the ones prescribed under the remit of the European regulation, namely reviewing and monitoring the development of the methodologies, the effectiveness of the internal controls and of the methodologies revision related functions. Alternatively, in the event that the rating agencies have not appointed independent directors, they shall assign the aforementioned functions to a person or area which shall be independent of the rating activities business lines, and who shall report directly to the board of directors.

231. For equivalence purposes, the monitoring activities assigned by the CRA Regulation to independent directors do not need to be undertaken by independent members of the board but have to be part of the overall responsibility of the senior management, and can be carried out by someone who is not involved in credit rating activities and whose compensation is arranged in such a way to ensure the independence of their judgment and the absence of links to the business performance of the credit rating agency.

In the Mexican Regulation, corporate governance objectives can be achieved using the same means than in the European Regulation by designating independent directors or alternatively through the requirements that impose the accomplishment of these responsibilities by the independent area referred to above.

a) Monitoring the development of credit rating policy and of the methodologies used by the credit rating agency in its credit rating activities;

232. CRAs in Mexico have obligations in relation to monitoring the development of rating methodologies encompassing namely: (i) a CRA should use rating methodologies that are rigorous, systematic, and subject to revisions based on historical experience, including comparisons of risk estimates with actual ones; (ii) a CRA should ensure that it has and devotes sufficient resources to carry out high-

quality credit assessments of all obligations and issuers it rates; (iii) a CRA should establish and implement a formal review function responsible for periodically reviewing the methodologies and models and significant changes to the methodologies and models it uses.

233. Regulation requires CRAs to periodically monitor and review their rating methodologies and models and to review structured finance ratings-related methodologies on at least on an annual basis. In the Mexican regime there's no specific requirement to annually review methodologies and models, other than the structured finance related methodologies, however there's a provision regarding the obligation to check the effectiveness of its internal controls on annual basis and to disclose this assessment in a report that needs to be submitted yearly to the CNBV and disclosed to the general public. This particular requirement will imply that they will necessarily be assessing the effectiveness of their methodologies for determining credit ratings and that therefore need to be monitored at least on an annual basis.

Regarding the internal control functions, the Mexican regime require a CRA to: (i) establish and implement a formal review function responsible for periodically reviewing the methodologies and models and significant changes to the methodologies and models it uses. This function has to be made up of managers with appropriate experience to review the feasibility of providing a credit rating for a type of structure that is materially different from the structures the CRA currently rates.

In addition, as previously indicated, the Board of Directors of the rating agency will also be responsible for approving methodologies or changes to them, prior to its use.

b) Monitoring the effectiveness of the internal quality control system

234. The Mexican regime requires CRAs' board of directors to appoint a person or area responsible for supervising the rating agency, its managerial and technical personnel, and other employees' compliance with the applicable regulation.

This compliance officer or area shall perform, on a daily and permanent basis, activities related to the establishment and updating of internal control mechanisms that allow the CRA's activities and services to be carried out in accordance with the policies and methods contained in the internal manuals.

The officer or area mentioned above shall also deliver to the person in charge of internal auditing, as well as to the chief executive officer, an annual report of its activities. This report shall be conserved for a period of 5 years and made available to the CNBV.

235. CNBV's Rules also impose that independent directors shall be competent for monitoring the effectiveness of internal control systems to ensure compliance and avoidance of conflicts of interest.

c) Monitoring of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or managed and disclosed

236. As indicated above, Mexican CRAs, by adherence to a Code, must assign these tasks to a compliance officer who is required to report to the board. This monitoring function required by regulation, provide that a compliance officer who has independent reporting lines and compensation, should be responsible, among other things to identify and eliminate conflicts of interest. CNBV's Rules require the establishment of internal control mechanism that allows the identification and elimination of any conflicts of interest that might influence the ratings, or may arise from other activities performed according to the bylaws of the company. Compliance monitoring records must be kept.

d) Monitoring the compliance and governance processes

237. The compliance officer or area, as identified above, has also the duty of monitoring the compliance and governance processes associated with the review function.

Expertise by the board members in financial services and in structured finance products

238. CNBV's Rules do not contain any specific provisions regarding the level of expertise of the members of the Board, nor a specific obligation for an independent or executive director to have an in-depth knowledge and experience at senior level as for the issuance of structured finance ratings, however the Mexican authorities have confirmed that as part of their on-going supervision practices they will be checking that members appointed to these positions will be fulfilling this requirement.

239. This practice is also supported by article 26 of the Mexican Securities Market Law, which constitutes a benchmark for rating agencies, establishing that the independent directors and, where applicable, their respective alternates shall be selected for their expertise, skills and professional prestige, further considering that they must perform their duties in a manner that is free from any conflict of interest and independent from their own interests. In addition to that, the Mexican law imposes in its article 393 a sanction in case of a lack of knowledge or ethical standards of the members of the board.

CORPORATE GOVERNANCE	**BOX 2**
ESMA considers that, overall the Mexican legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to corporate governance. They are achieved through the existence of a Board of Directors, the appointment of independent members and the assignment of a number of responsibilities that make them accountable for the management of the rating agency.	

III. Conflicts of interest management

240. CRAs must have in place adequate arrangements for the identification and elimination of conflicts of interest that arise in their business. Depending on the circumstances, appropriately managing a conflict of interest may involve avoidance for most of the cases, or disclosure to the compliance person or area only for very limited cases, that would also be allowed under the European Regulation. In addition, CRAs are required adherence to the provisions of a Code, including those concerning independence and management of conflicts of interest and requirements to be organised in a manner that ensures its business interest does not impair the independence and accuracy of its credit rating activities.

241. The rating agencies shall establish documented procedures and mechanisms designed to identify and eliminate and, if applicable, inform the person or area responsible for ensuring compliance with the norms, of any potential conflict of interest that could influence the ratings, in any case, the disclosure of potential conflicts of interest to the compliance area shall, at all times, be clear and complete. (Annex 1. Section. IV. Independence and conflicts of interest. Paragraph B).

242. The disclosure to the public is only provided in the code of conduct, in the event that the rating agency received income from the rated entity, for any services other than those related to the study,

analysis, opinion, evaluation and ruling regarding the credit quality and the awarding of a rating, said situation shall be mentioned indicating the proportion thereof with respect to those perceived as compensation for its principal activity.

243. Under the Mexican regulation, CRAs cannot manage and disclose conflicts of interests, they must identify and eliminate them. Provided there is a conflict, credit rating agencies have the obligation to eliminate it, this is the reason why disclosure to the public is not required. In any case, the person or area responsible for ensuring compliance with norms must be informed of any potential conflict of interest that could influence the ratings.

244. There are two situations under which a potential conflict of interest (among the ones permitted under the EU Regulation) could be allowed without the obligation to disclose it to the general public:

- CRAs are not required to publish the list of rated entities or related third parties from which it receives more than 5% of its annual revenue. This information has to be provided to the CNBV on an annual basis.
- Situations in which a rated entity maintains an interest or participation of less than 5% of the share capital of the rating agency are allowed, and there is no obligation to make public the potential conflict. However, participations of 5% or more in the share capital of the credit rating agency would result in a prohibition to rate the entity holding this stake.

Both circumstances will be disclosed to the regulator, so that it can monitor and supervise how the credit rating agency is managing the conflicts that may arise in this respect.

Disclosure of names of main rated entities

245. CNBV's Rules require a CRA to disclose to the Mexican Securities Commission on an annual basis entities or related third parties from which it receives 5% or more of its annual revenue. In addition to that, a rating agency is prohibited to issue or maintain a credit rating on an entity from which it has received 10% or more of the rating 's agency total income in the preceding year.

Ownership of financial instruments

246. CRAs are required to comply with a Code of conduct that must prevent it, its board members, senior management and employees from participating in or influencing a rating where they own securities or derivatives of the rated entity, or where they have had a relationship with a rated entity or related party thereof that may cause or may be perceived as causing a conflict of interest.

In addition to that, rating agencies must establish mechanisms to ensure that investments in securities and derivative financial instruments of the members of the board, CEO, directors, commissioners, stakeholders and technical staff responsible for the assignments and monitoring of credit quality values of the institution or rating entities, do not generate conflict of interest.

The Code must also provide that CRAs disclosure of actual and potential conflicts of interest to the compliance person or area should be complete and timely.

247. Furthermore, article 338 of the Mexican Law establishes that CRAs are prohibited from entering into services agreements for the ratings of securities issued by issuers to which its partners, directors or officers have conflicts of interest. In this same line, code of conduct also establishes that CRAs are required to ensure that the assigned ratings and their surveillance are not be affected by the business relationships, current or future, with the clients to whom they provide their services and the other firms that are part of the Corporate Group to which they belong.

Rotation of rating analysts and persons approving credit ratings

248. CNBV's Rules establish that the board of directors of the rating agencies shall approve guidelines and policies stipulating the systematic rotation of the committees or technical staff responsible for the development and, where appropriate, monitoring of opinions about credit quality, and the gradual introduction of the successors of those committees or technical staff with respect to the same rated entity, establishing maximum periods of continuance in each area of responsibility.

249. Rules also establish that CRAs annual report has to include a description of the policy for rotation of technical personnel responsible for the development and when appropriate, monitoring of opinions about the creditworthiness of securities and issuers.

Consultancy or advisory services

250. Mexican CRAs, their managerial and technical personnel and any other employees, may not issue recommendations or proposals related to the issuance of securities with respect to which they provide their rating services, nor with respect to the activities of the issuer, underwriter or any other of the offer's participants.

Involvement of rating analysts in the negotiation of fees and compensation

251. Mexican CRAs must abide a code of conduct that prohibits a CRA from involving its technical staff in activities related to the collection of fees or payments owed by the rated entities or by any company belonging to the group of the rated entity.

252. Regarding the staff compensation, CRAs must refrain from compensating or evaluating the performance of their senior management and technical staff based on the revenue such CRA receives from the ratings granted to a rated entity.

Ancillary services

253. The Mexican regulation, in its applicable rule, defines CRAs as having an exclusive scope of business which is providing credit ratings on securities, to this regard any other service CRAs could possibly provide to their clients should be authorised by the Commission. So far none of market forecasts, estimates of economic trends, pricing analysis and other general data analysis and related services have been authorised to be provided.

    Upon publicly disclosing their ratings, CRAs must indicate whether they have received from the same issuer, fees related to services different from ratings services and their percentage in connection with the ratings services fees.

CONFLICTS OF INTEREST MANAGEMENT **BOX 3**

ESMA considers that, overall, the legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to conflicts of interest management, and points out that the framework includes provisions which are similar in their large majority to those of the EU Regulation.

In general, the fact that under the Mexican regulation rating agencies cannot manage and disclose conflicts of interest, but identify and eliminate them, makes this framework more stringent than the EU Regulation, this circumstance along with the obligation to disclose a number of permitted conflicts to the CNBV makes ESMA to conclude that investor protection should be covered.

IV. Organisational requirements

254. The Mexican Securities Market Law along with its Rules set the requirements to ensure the independence between a CRAs business interest and its rating activities. CNBV's Rules, by requiring adherence to a code of conduct, that has to be prepared following the minimum guidelines set forth under its Annex 1, require a CRA to be organised in a manner that ensures its business interest does not impair the independence of its credit rating activities

255. CNBV requires applicants to demonstrate as part of the registration process and as an on-going obligation, that they have the organisational competence to provide rating services. Applicants must nominate in their application the people on whom they will depend for the different areas of responsibility and they must provide a study of financial feasibility proving the existence of sufficient resources to maintain an adequate operation for at least the first twenty four months of operation, along with a demonstration that these people have the appropriate knowledge and skills

256. With regard to the general organisational requirements, a rating agency must establish and implement a code of conduct compliant with international standards and minimum requirements determined by CNBV. Such code must contain provisions ensuring that:

(a) CRAs carry out their activity in compliance with the applicable laws and regulations; and

(b) CRAs implement a specific compliance function for monitoring compliance with applicable laws and regulations, and for developing policies and procedures to address the principles in the code.

The Mexican regulatory regime does not contain an explicit requirement for a rating agency to establish administrative and accounting procedures, nor contain specific requirements to have effective procedures for risk assessment, however, in practice this could be covered by the fact that CBNV would expect rating agencies to have these procedures in place, as the absence of this may raise concerns about the ability of the compliance officer to carry out its tasks of ensuring compliance with the securities laws and regulations. Furthermore, the CNBV can exercise its discretion and use its power to deny the application on the basis that the rating agency does not have sufficient managerial and financial resources to determine credit ratings with integrity pursuant to Provision 2.VI and 10.V. of CNBV's Rules, and understands that in practice the CNBV would check compliance with the regulatory requirements through its cycles of inspections.

257. With regard to the compliance officer, Annex I. Section I, A).2 of CNBV's Rules, provides that CRAs shall have a person or department responsible for monitoring compliance with the applicable regulations by their senior management, technical staff and other employees. The reporting lines and compensation of the staff assigned to the aforesaid department must be independent of the analysis and credit rating services.

258. With regard to the resources devoted to the continuity and regularity on the performance of CRA's credit rating activities and their on-going monitoring, Mexican CRA Regulation has in place similar requirements to the ones in the EU (CNBV's Rules, section 2. II, III, VI, VII, & VIII).

Outsourcing

259. There is no express provision prohibiting or limiting Mexican CRAs to outsource any of their functions, nor a legal provision so that outsourced activities do not to impair the CRA's internal controls, however, the Mexican Regulation can be considered to meet the objectives of the EU Regulation due to the fact that rating agencies are still directly responsible for maintaining all internal controls mandated by law or regulation, and they remain fully liable for all outsourced

activities. Furthermore, outsourcing would not impair the ability of the relevant authority to supervise the CRAs compliance with its obligations, as entities that provide outsourcing services to CRAs are subject to supervision in Mexico.

CNBV also confirmed that they will be supervising on an ex post basis that outsourcing did not impair the ability of the agencies to issue ratings with integrity and in compliance with the Mexican requirements. In addition to that, Mexican authorities confirmed that no major outsourcing was being carried out by existing CRAs.

Confidentiality

260. Rating agencies must have internal manuals that set forth policies for the adequate handling of information. CRAs are bound to establish mechanisms to ensure that the confidential information they receive is used only for purposes related to credit rating activities, and to have adequate measures to protect customers' records.

To this regard CNBV's Rules in its Annex I. Section III, on the appropriate use of relevant information, establishes that rating agencies must establish mechanisms to ensure that confidential information that has been gathered for determining a credit rating, is used only for purposes related to credit rating activities. To this end, they shall provide at least the following aspects:

- means for receiving the information which must be provided by the issuers, in order to issue or monitor a rating.
- procedures to protect the information that the credit rating agency receives, because of its activities and the services provided, from issuers, in accordance with the confidentiality agreements entered.
- adequate measures to protect customers' records in possession of the credit rating agency against fraud, theft or misuse.

Record keeping

261. The Mexican Securities Act provides in its article 330 that all regulated entities must arrange the adequate handling of the information they receive relating to their activities, and keep it for a period of five years. The provision is silent as to the place or facilities for storing such records, but the general principle applies to CRAs that must provide for adequate handling of the information they receive for the rating process.

ORGANISATIONAL REQUIREMENTS **BOX 4**

ESMA considers that, overall, the Mexican legal and supervisory framework achieves the objectives of the EU regulatory requirements in relation to organisational requirements, including outsourcing, record keeping and confidentiality.

CRAs in Mexico are in general not prohibited to outsource or limited in outsourcing rating activities or other business functions, however it can be considered to meet the objectives of the EU Regulation, as rating agencies are still directly responsible for maintaining all internal controls mandated by law or regulation, they remain fully liable for all outsourced activities, and entities that provide outsourcing services to CRAs are subject to supervision in Mexico.

V. Quality of methodologies and quality of ratings

262. CNBV's Rules assign to the independent directors the specific function of reviewing and monitoring the development of the methodologies for the study, analysis, opinion and evaluation of the credit quality of issuers or instruments, as well as the responsibility to check the effectiveness of these methodologies revision related functions. In the event that rating agencies do not appoint any independent directors, they shall assign this review function to a person or area which shall be independent of the rating functions and who shall report directly to the Board of Directors.

263. In addition, the Board of Directors of rating agencies will be responsible for approving the methodologies for determining the credit quality of securities or rated entities prior to their use for the first time. The aforementioned is without prejudice to have committees or officials that contribute to the development of such methodologies.

264. Mexican CRAs must monitor on a continued basis and, as appropriate, timely update the ratings they have assigned, with the exception of ratings which are clearly indicated at the time of their publication not to be subject to on-going monitoring.

Periodicity of the review

265. The Mexican Regulation requires CRAs to periodically monitor and review their rating methodologies and models, and to review structured finance ratings-related methodologies at least on an annual basis.

266. There´s no specific requirement to annually review methodologies and models, other than the structured finance related methodologies, however the Mexican Regulation also envisages a provision regarding the obligation to check the effectiveness of its internal controls on annual basis and to disclose this assessment in a report that needs to be submitted yearly to the CNBV and disclosed to the general public. This particular requirement will imply that they will necessarily be assessing the effectiveness of their methodologies for determining credit ratings and that therefore need to be monitored at least on an annual basis.

267. CNBV confirmed that, as part of this assessment on the internal controls that has to be included in their annual report, rating agencies would be covering the effectiveness of the methodologies they use to determine ratings.

Key rating assumptions

268. Key rating assumptions are included in the required review function, although it is not specified as a separate item since it is considered as an intrinsic part of the methodology and models. The review of the key rating assumptions is then part of the review function.

12-hour rule

269. CNBV's Rules provide for a prior notification of the rating to be given to the issuer for clarification purposes or identification of confidential information which should not be disclosed. However, Regulation also envisages that in the contract the CRA signs with its clients, they could agree the assumptions under which CRA could disclose a rating without this prior notification. In the event that rating agencies do not inform the rated entity before the publication of a rating or modification to it, they shall inform it immediately following the publication, indicating the reasons for the omission.

Minimum quality of information

270. CRAs are required to have documented procedures to ensure that their ratings are based on a careful analysis of all relevant information, in accordance with the qualitative and quantitative methodologies contained in their internal manuals.

271. CRAs must adopt measures to avoid the assignment of inaccurate or confusing ratings and must inform the issuer of the form and frequency in which the latter shall provide the information for the rating process.

To this regard, the Mexican Regulation imposes that rating service agreements adopted between the CRAs and the issuers must provide for the information to be requested and timeframes for its provision, so that credit ratings could be assign as well as monitored.

Mexican Regulation also requires that, upon publicly disclosing their ratings, CRAs must publish a release which, among others, includes a reference to the scope of their review of the information received from the rated institution, in connection with the rating process; and the information sources, including the one provided by third parties.

Dynamic assessment of methodologies

272. CRAs are required to use rating methodologies that are rigorous, systematic, and, where possible, result in ratings that can be subjected to some form of objective validation based on historical experience, where information is available for this, including comparisons of risk estimates with those risks actually observed. The requirement does not include that the methodology is continuous and validation is mandatory.

Changes in methodologies and model

273. In the event that a modification is made to the models and methodology used for the determination of a credit rating, rating agencies shall employ said methodology and models both for the initial ratings awarded as well as for any that follow. In these cases the rating agency must analyse whether such amendments may impact the ratings assigned under the previous methodologies/ models, placing those ratings under observation, and adopting any appropriate rating action within 6 months. This condition does not apply to an affected credit rating that clearly indicates that it does not entail on-going review.

QUALITY OF METHODOLOGIES AND QUALITY OF RATINGS **BOX 5**

ESMA considers that, overall, the Mexican legal and supervisory framework does achieve the objectives of the EU regulatory requirements in relation to the quality of methodologies and quality of ratings.

ESMA understands that CRAs in Mexico are required to periodically review their ratings, methodologies and models; where there has been a material change to the methodology, all affected ratings must be reviewed within 6 months of the change.

VI. General disclosure and presentation of ratings

(a) Disclosure of credit ratings

Timely and non-selective disclosure

274. CNBV's Rules require CRAs to disclose their credit ratings, as well as modifications or cancellations, the same day that they are adopted to the CNBV, the Mexican Stock Exchange and the public.

Unsolicited ratings

275. Unsolicited ratings are forbidden under the Mexican Regulation.

Historical performance of ratings

276. CNBV's Rules establish that credit rating agencies must disclose to the public, free of charge and non- selectively, through their websites, historical information on default rates for each of the rating categories, and the transition matrix between the ratings granted.

Material sources

277. Several provisions in the Mexican Regulation require information about how the rating was reached, which methodology was used and any key elements underlying the rating opinion. Considered together they have the same net outcome as a requirement to indicate all material sources used to prepare a credit rating.

278. Moreover, CRAs have to indicate the principal methodology or methodology version that was used in determining the rating and where a description of that methodology can be found. Where the rating is based on more than one methodology, the CRA must explain this fact in the ratings announcement, and indicate the manner in which the different methodologies and other important aspects were factored into the rating decision.

Release date and update of credit ratings

279. Mexican CRAs are required to indicate clearly and prominently, the date of the press release, the date at which the rating was last updated and the rating prior to the date of the press release.

Disclosure of quality of information used in the rating process

280. The Mexican Regulation, require CRAs to disclose (i) the sources of information used to determine a rating, included those provided by third parties; (ii) the attributes and limitations of each rating, and the extent to which the CRA verifies the relevant information provided to it by the rated entity.

281. There is not a specific provision for rating agencies to issue or discontinue a credit rating if they are not satisfied with the quality of the information on which to base the rating, however the combination of a number of provisions embedded in the Mexican Regulation, as described below, could be considered to meet the same objectives than the EU Regulation:

- CRAs are required to have documented procedures to ensure that their ratings are based on a careful analysis of all relevant information, in accordance with the qualitative and quantitative methodologies contained in their internal manuals.
- CRAs must adopt measures to avoid the assignment of inaccurate or confusing ratings and

must inform the issuer the form and frequency in which the latter shall provide the information for the rating process.

- Rated entities must provide periodically, and in time, the information required by the rating agency in order for the latter to be in a position to issue and monitor the ratings awarded. In case the entity does not provide the information required, the rating agency may not give advice and monitor the rating assigned, and must disclose such situation on its website.

Disclosure of information on structured finance ratings

282. The Mexican Regulation requires a CRA (i) to provide sufficient information about its loss and cash flow analysis for a structured finance product; (ii) to analyse the sensitivity of the rating to changes in the CRA's rating assumptions; and (iii) reveal the manner in which the analysis of the underlying assets backing up the securities was considered for the determination of the rating.

283. CNBV's Rules also provide the obligation to differentiate these ratings from those corresponding to traditional corporate bonds, preferably through a different rating symbology.

284. These provisions meet the objectives of the EU requirements by providing sufficient information to enable investors to deal with the additional complexity of these products and also to understand the level of assessment conducted by the rating agency on the due diligence processes carried out at the level of the underlying assets.

(b) Disclosure concerning the credit rating agency and its activities

Public register of CRAs

285. No entity is able to provide credit ratings in Mexico unless they are registered as a credit agency. CNBV is required to maintain a register of all the ratings issued by authorised CRAs which is accessible to the public.

Ancillary services

286. CNBV's Rules require that upon publicly disclosing their ratings, CRAs must disclose whether they have received from the same issuer fees related to services different from ratings services and their percentage in connection with the ratings services fees.

Although Rating Agencies are required to disclose the ancillary services that they may have provided, in the press release, CNBV has confirmed that all the services that rating agencies provide to their clients have to be authorized by them, and so far, rating agencies do not offer any service different than rating services.

Compensation arrangements

287. Under the Mexican Regulation a CRA do not have to disclose the general nature of its compensation arrangements with rated entities to the public. However, Mexico has rules regarding the compensation CRAs received from major clients. To this regard, rating agencies must provide the CNBV with the list of their 20 largest clients, as determined by revenues received on an annual basis, noting cases in which the income from these entities accounted for five per cent or more of the total income. Moreover, a rating agency is prohibited to issue or maintain a credit rating from an entity from which it has received ten per cent or more of the rating agency's total income in the preceding year.

288. Mexican CRAs are not required either to publish the list of rated entities or related third parties from which it receives more than 5% of its annual revenue. This information has to be provided to

the CNBV on an annual basis so that it can monitor and supervise how the credit rating agency is managing the conflicts that may arise in this respect.

289. Provisions 2.V and 5 of CNBV's Rules also requires Mexican CRAs to provide the Commission with the services contracts or agreements, executed with the entities that have required its services, along with the minimum stipulations that shall be contained in this contracts (information required to provide the service, the term for delivery, the rating agency's non-liability for the effects generated on the rated entity or any third party, confidentiality of information, the rating agency's obligation of prior notification to the issuer).

Other items subject to disclosure

290. The Mexican Regulation also requires CRAs to disclose (i) their policy concerning publication of credit ratings and other communications; (ii) the description of methodologies, models and key rating assumptions such as mathematical or correlation assumptions used in its credit rating activities; (iii) any material modifications to its methodologies and significant practices, procedures and processes; (iv) the CRA's code of conduct.

Periodical disclosure

291. Credit rating agencies shall disclose to the public, free of charge and non-selectively, through their websites, historical information on default rates for each of the rating categories, where possible, and the transition matrix between the ratings granted. This information has to cover to the three most recent years for each of the rating categories offered, and has to be provided within the first five working days of each calendar year.

Annual disclosure

292. CRAs have to make public an annual report including, among other information, a description of the legal structure, the internal control mechanisms accompanied by an assessment of their effectiveness, changes to rating methodologies and criteria, as well as to its code of conduct, a statistical report on its ratings performance, statistics on staff allocation to analytical activity (both initial ratings and surveillance, model and criteria reviews), details of its record management procedures, analyst and managers rotation policy, functions and procedures related to compliance, and internal auditing and rated entities support.

DISCLOSURE OF RATINGS **BOX 6**

There are two distinct types of disclosure requirements in the EU Regulation: (i) those relating to the disclosure that a credit rating agency needs to make on a rating-by-rating basis, and (ii) those relating to the credit rating agency itself.

(a) Disclosure of credit ratings

ESMA considers that the Mexican legal and supervisory framework, overall, does achieve the objectives of the EU requirements that relate to disclosure of credit ratings.

(b) Disclosure concerning the credit rating agency and its activities

ESMA considers that, the Mexican legal and supervisory framework, overall, achieves the objectives of the EU requirements that relate to disclosure regarding the credit rating agency and its activities.

VII. Effective supervision and enforcement.

293. Under the Mexican Law, the CNBV is responsible for supervising and regulating entities in the Mexican financial system, in order to pursue stability and proper operation, and to maintain and promote a healthy and balanced development of the system as a whole.

294. Article 350 of the Securities Market Law establishes that the CNBV shall have powers of supervision, in terms of the CNBV's Act, regarding securities market intermediaries, self-regulatory bodies, stock exchanges, companies that manage systems to facilitate transactions in securities, institutions for security deposits, central security counterparties, credit rating agencies and price providers.

    To this end, the CNBV may conduct on-site inspections at any of the entities listed and require, within the term and in the manner deemed pertinent by the CNBV itself, all information and documentation necessary to verify compliance with the Securities Market Law and the general provisions that arise therefrom.

Powers of the relevant authority

295. As previously indicated, under the Mexican Securities Market Law, the CNBV is directly responsible for the supervision of credit rating agencies in Mexico. To this end, article 355 of the Securities Law empowers the CNBV to investigate any actions or issues that might constitute o could constitute a breach of the law, for this purpose, it has powers to:

    - request any type of information and documents to any person or authority who might contribute to the development of the investigation.
    - carry-out on-site inspections.
    - summon any person who might contribute to the investigation.
    - hire the services of auditors and other professionals.

296. Articles 393 and 394 of the Securities Market Law lay down penalties specifically applicable to CRAs, ranging from a permanent or temporary bar (3 months to 5 years), to suspension and license revocation.

297. The CNBV may impose fines, in the amounts and cases detailed in article 392 of the Securities Market Law, such as CRA's failure to timely inform to the Commission of amendments to the information filed for registration, its failure to disclose ratings' assignment, changes or withdrawals in the manner and timeframe set forth by regulation and undue disclosure/misuse of material non-public information, including for engaging in securities transactions.

    Violations of the Securities Market Law or general provisions derived thereunder shall be punished with administrative fines imposed by the CNBV, at the rate of days of the minimum daily wage, ranging from 200 to 100,000 days of salary (approximately from 500$ to 500.000$).

298. CNBV may also enter into arrangements with other bodies to facilitate cooperation between regulators in performing supervisory and investigative functions. For example, memoranda of understanding between CNBV and other regulatory bodies typically set out the parties' intent to cooperate with each other in executing the laws and regulations applicable in the respective jurisdictions in relation to the discharge of their responsibilities in relation to regulated entities.

EFFECTIVE SUPERVISION AND ENFORCEMENT	**BOX 7**
ESMA considers that the Mexican legal and supervisory framework ensures that the CNBV is entrusted with sufficient powers to enable effective supervision and enforcement over credit rating agencies.	

c) Conclusion on the equivalence status regarding the Mexican legislative and regulatory framework

GLOBAL ASSESSMENT	**BOX 8**
ESMA concludes that overall the Mexican legal and supervisory framework is equivalent to the EU regulatory regime for CRA in terms of what ESMA considers to be overall objective of: "assuring that users of ratings in the EU would benefit from equivalent protections in terms of the CRAs integrity, transparency, good governance and reliability of the credit rating activities" However, only if all the other conditions set out in Article 5(1) of the EU Regulation are met, can a third country credit rating agency be granted certification. These conditions are that: -the credit rating agency is authorised or registered in and is subject to supervision in that third country; -cooperation arrangements are operational; -the credit ratings issued by the credit rating agency and its credit rating activities are not of systemic importance to the financial stability or integrity of the financial markets of one or more Member States.	

Chapter IV- Assessment of HONG KONG

Key to the references and terms used in this advice:

CRAs: credit rating agencies

COC: Code of Conduct for Person Providing Credit Rating Services

General SFC Code: Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

HK CRA Regime: the regulatory regime governing credit rating agencies operating in Hong Kong

Internal Control Guidelines: Management, Supervision and Internal Control Guidelines

SFO: Securities and Futures Ordinance

SFC: Securities and Futures Commission

Executive summary

Following ESMA's decision on 15 March 2012 to consider the Hong Kong regulatory regime as being in line with the requirements defined in Article 4(3) of the EU Regulation on CRA (ESMA/2012/158), this chapter sets out the technical advice of ESMA in relation to the equivalence between Hong Kong supervisory framework and the EU regulatory regime for credit rating agencies, in accordance with the initial European Commission's mandate of 12 June 2009.

ESMA concludes that, overall, the Hong Kong and supervisory framework is equivalent to the EU regulatory regime for credit rating agencies in terms of achieving what ESMA considers to be the overall objective of:

"assuring that users of ratings in the EU would benefit from equivalent protections in terms of the credit rating agencies integrity, transparency, good governance and reliability of the credit rating activities".

In coming to this conclusion, ESMA has verified whether the Hong Kong legal and regulatory framework for Credit Rating Agencies met the requirements of the EU Regulation grouped for the purpose of this assessment into seven areas[13], in relation to each of which ESMA has assessed the ability of the Hong Kong legal and supervisory framework to achieve the main objectives of the relevant EU requirements. However, only if all the conditions set out in Article 5(1) of the EU Regulation are met, a third country CRA can be granted certification, for example that the CRA is authorised or registered in and is subject to supervision in that third country.

ESMA considers the Hong Kong framework to be comprehensive and in many instances similar to the EU Regulation.

There are no areas where the requirements do not meet the objectives of the EU requirements; there are no shortcomings, and (as such) ESMA has no recommendations to make in respect of the legal and supervisory framework as a whole for the purposes of an equivalence determination by the European Commission.

ESMA will keep monitoring the evolution of the Hong Kong legal and supervisory framework for credit rating agencies on an on-going basis, also via the cooperation agreements that the SFC and ESMA have signed in that field (ESMA/2012/158). It will update the European Commission in the event of future changes to the Hong Kong regime that may necessitate a change in the conclusions of this report.

[13] These seven areas are:
1. The scope of the regulatory and supervisory framework
2. Corporate Governance
3. Conflicts of interest management
4. Organisational requirements
5. Quality of methodologies and quality of ratings
6. Disclosure
7. Effective supervision and enforcement.

Assessment of Hong Kong

299. This section of the report explains how ESMA assesses the equivalence between Hong Kong regulatory and supervisory framework and the EU regulatory regime for credit rating agencies.

300. This section is divided as follows:

a) Hong Kong legal and supervisory framework;

b) the assessment of the equivalence on that framework to that of EU.

301. This section outlines the general differences between the EU and Hong Kong approach on implementing the credit rating agency registration and oversight regime.

a) Hong Kong legal and supervisory framework

Overall philosophy of approach

302. The powers of the Securities and Futures Commission ("SFC") are principally derived from the Securities and Futures Ordinance ("SFO"), which was enacted by the Hong Kong Legislative Council and constitutes primary legislation.

303. Powers conferred on the SFC by the SFO include its powers to make rules (otherwise known as subsidiary or subordinate legislation) and to publish codes and guidelines (SFO sections 169 & 399). Rules, guidelines and codes are subordinated to the SFO and will be struck down by the courts as ultra vires and invalid if they are inconsistent with the provisions of the SFO or, in any manner, are outside of the scope of the provisions of the SFO under which they are made.

304. The regulatory regime governing credit rating agencies ("CRAs") operating in Hong Kong ("HK CRA Regime") became effective on 1 June 2011. The amendments to the SFO and the Code of Conduct for Person Providing Credit Rating Services ("COC") came into effect on the same day.

305. Under the HK CRA Regime, CRAs and their rating analysts who provide credit rating services in Hong Kong are required to be licensed for Type 10 regulated activity and subject to supervision by the SFC. They are also required to comply with the COC which contains the specific requirements regarding CRAs and other legal and regulatory requirements generally applicable to all SFC licensees.

b) The assessment of the equivalence on Hong Kong framework to that of EU

306. The HK CRA Regime has been up and running since 1 June 2011.

307. Against this background, an assessment of the HK CRA Regime has been conducted. In carrying out that assessment, Staffs from ESMA have conducted an analysis of the regime in force in Hong Kong from an objectives-based perspective. In carrying out that assessment, the working group has verified its understanding of the relevant provisions through on-going informal contacts with the SFC.

308. The HK CRA Regime has been tested against the objectives pursued by the EU Regulation in the

seven areas where it establishes requirements, which are identified in ESMA's Guidelines on Endorsement (ESMA/2011/139, Annex II). These areas are:

(I) the scope of the regulatory and supervisory framework;

(II) corporate governance;

(III) management of conflicts of interest;

(IV) organisational requirements;

(V) quality of methodologies and of ratings;

(VI) general disclosure and presentation of ratings;

(VII) effective supervision and enforcement.

309. As a background to this advice, on 15 March 2012 ESMA informed market participants that it considered the recently adopted regulatory regime for CRAs in Hong Kong embeds requirements which follow closely those in place in the EU. As a consequence, the HK CRA Regime is assessed as fulfilling the "as stringent as" test set out in Article 4(3) (b) of Regulation No 1060/2009.

310. Finally, as regards the cooperation arrangements required by Article 5 (7), a MoU between ESMA and the SFC concerning supervision of CRAs has been established on 7 March 2012.

I. **The scope of the regulatory and supervisory framework**

311. The amendments to the SFO and the COC came into effect on 1 June 2011. Under the HK CRA regime, CRAs and their rating analysts who provide credit rating services in Hong Kong are required to be licensed for Type 10 regulated activity and subject to supervision by the SFC. "Representative" referred to in the COC covers rating analysts, as a rating analyst of a CRA is required to be licensed as a representative under the SFO for providing crediting rating services.

312. The rules under the HK CRA Regime are also designed with the intent to be consistent with international regimes and European Commission endorsement and certification provisions, so that European market participants can rely on ratings of Hong Kong Licensed CRAs associated with those registered in Europe.

313. Upon licensed or registered, the CRAs are required to comply with the COC in addition to the relevant requirements under the SFO, codes and guidelines that are currently applicable to the licensed or registered persons of other types of regulated activities, such as the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("General SFC Code") and the Management, Supervision and Internal Control Guidelines ("Internal Control Guidelines")[14].

314. Schedule 5 of the SFO provides definitions on the following terms :

[14] The SFC gets its authority from the SFO that – as the legal basis - gives the SFC the power to issue Codes, rules and guidelines.

(i) “Credit ratings” is defined as opinions, expressed using a defined ranking system, primarily regarding the creditworthiness of i) a person other than an individual, ii) debt securities and iii) an agreement to provide credit.

(ii) “Providing credit rating services” is defined as:

(a) preparing credit rating (for dissemination to the public, whether in Hong Kong or elsewhere: or with a reasonable expectation that they will be so disseminated; or

(b) preparing credit ratings (for distribution by subscription, whether in Hong Kong or elsewhere; or with a reasonable expectation that they will be so distributed,

However, it does not include the following:

(a) preparing, pursuant to a request made by a person, a credit rating which is exclusively prepared for, and provided to, the person and that is neither intended for dissemination to the public or distribution by subscription, whether in Hong Kong or elsewhere, nor reasonably expected to be so disseminated or distributed; or

(b) gathering, collating, disseminating or distributing information concerning the indebtedness or credit history of any person.

(iii) “Debt securities” are defined as debenture stocks, loan stocks, debentures, bonds, notes, indexed bonds, convertible debt securities, bonds with warrants, non-interest bearing debt securities, and other securities or instruments acknowledging, evidencing or creating indebtedness.

(iv) “Preferred securities” are defined as preference shares, preferred shares or preferred stock.

315. In addition, the COC also defines the following terms which are only for the purposes of the COC :

(i) “CRA” are defined as “licensed corporation” or “registered institution” (as defined in Part 1 of Schedule 1 of the SFO), which is licensed or registered to carry on business in Type 10 regulated activity.

(ii) “Structured finance products” are defined as securities or a money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction.

316. As regards assurance that the SFC or other public authorities in Hong Kong are allowed to influence the content of credit rating ore credit rating methodologies, the SFC clarified that it will not interfere with the proper conduct by the CRAs of the business for which they have been licensed in Hong Kong and also has no power to do so under the SFO. Therefore, the SFC is not in a position to interfere with the content of a credit rating report issued by the CRA and/or with the rating methodology used by it in the preparation of any such report.

THE HONG KONG LEGAL AND REGULATORY FRAMEWORK FOR CRA	BOX 1
The HK CRA Regime has a comprehensive and legally binding framework in relation to the licensing and supervision of CRAs and preventing interference with the analytical content of ratings and methodologies. Overall, it is clear that both the EU and Hong Kong regimes share the same overall objectives namely, to ensure that CRA ratings are carried out fairly and from an independent standpoint.	

II. **Corporate governance**

317. The EU mandate on assessing the equivalence between certain non-EU countries and the EU regulatory regime for CRAs required ESMA to at least check that" two independent directors of the CRA's administrative or supervisory board are tasked with monitoring the credit rating policies, effectiveness of the internal quality control system as well as the internal controls and measures established to deal with conflicts of interest".

Hong Kong approach to corporate governance

318. Under the HK CRA Regime, the structure of a limited company does not include an administrative or supervisory board. However, as a licensed corporation, the CRA has to comply with Section 125 of the SFO – and as such there need to be two responsible officers for regulated activities both of whom have to be approved by the SFC – and at least one of them has to be an executive director.

319. As regards **responsibilities assigned to the administrative or supervisory board**, under the HK CRA Regime, they are covered by the COC (paragraph 24, 38 and 39), the Internal Control Guidelines (Part V) and the General SFC Code (General Principle 9 – Responsibility of senior management).

320. Under General SFC Code (General Principle 9), the senior management of a CRA (i.e. board of directors and responsible officers) should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the CRA.

321. Under paragraph 24 of the COC, a CRA should institute policies and procedures that clearly specify a person responsible for compliance by the CRA and its employees with the provisions of its code of conduct (as further described under paragraph 68 of this Code) and with any law, rules, regulations, codes or other requirements which apply to the CRA and are issued, administered or enforced by the SFC or any other regulatory authority or agency. This person's reporting lines and compensation should be independent of the CRA's rating operations.

322. As regards the **reporting lines for representatives**, and their compensation arrangements, the CRA framework provides that they should be structured as to eliminate, or effectively manage, actual or potential conflicts of interest (paragraph 38 of the COC).

323. With regard to **compensation arrangements**, a CRA's code of conduct should state that a representative will not be compensated or evaluated on the basis of the amount of revenue that the CRA derives from rated entities that the representative rates or with which the representative regularly interacts (paragraph 39 of the COC). A CRA (or its affiliates) should conduct formal and periodic reviews of compensation policies and practices for its representatives and employees who

participate in, or who might otherwise have an effect on, the rating process to ensure that these policies and practices do not compromise the objectivity of its rating process. (Paragraph 40 of the COC).

324. With regard to **level of expertise in financial services**, a CRA should use representatives who, individually or collectively (particularly where rating committees are used), have appropriate knowledge and experience in developing a credit rating of the type being prepared. (Paragraph 7 and 11 of the COC). In addition, a CRA should establish a formal review function made up of one or more senior staff members with appropriate experience to review the feasibility of providing a credit rating for a financial product that is materially different from the financial products the CRA currently rates.

325. Finally, as regards **responsibility incumbent on the senior management of a CRA**, i.e. board of directors and responsible officers, without explicitly mentioning the responsible person, the CRAs must ensure that the following tasks of monitoring have been taken into consideration:

(i) the development of the credit rating policy and of the methodologies used (COC paragraph 12, 15 and 16);

(ii) the effectiveness of any internal quality control system (COC paragraph 12);

(iii) the effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified and either eliminated or managed and disclosed (COC paragraphs 32, 33, and 38),

(iv) the compliance and governance processed (COC paragraph 12).

CORPORATE GOVERNANCE **BOX 2**

Overall, corporate governance is an adequate component of the Hong Kong regime for CRAs.

Whatever differences in approaches of corporate governance, ESMA considers that the requirements that are in place meet the objectives of this section on the basis that the independence of the CRA is achieved through specific policies that is to be demonstrated to the SFC.

ESMA believes that the objectives of the EU Regulation in the corporate governance section are met by the Hong Kong regulatory framework.

III. Conflict of interest Management

326. The EU mandate required ESMA to check at least the following issues:

(i) a CRA identifies and eliminates (or manages and discloses) conflicts of interest;

(ii) a CRA ensures that business interest does not impair the independence and accuracy of ratings

(iii) a CRA does not provide consultancy or advisory services

(iv) a CRA refrains from issuing a rating when it has direct or interest in the entity asking for a rating

(v) under paragraph 23 of the COC, a CRA should prohibit its representatives who are involved in the rating process from making proposals or recommendations regarding the design of structured products that the CRA rates.

(vi) under paragraph 41 of the COC, representatives who are directly involved in the rating process should not initiate, or participate in, discussions regarding fees or payments with any entity they rate.

(vii) under paragraph 39 of the COC, a CRA's code of conduct should state that a representative will not be compensated or evaluated on the basis of the amount of revenue that the CRA derives from rated entities that the representative rates or with that the representative regularly interacts.

(viii) under paragraph 40 of the COC, a CRA should also conduct formal and periodical reviews of compensation policies and practices for its representatives and employees who participate in the rating process to ensure that these policies and practices do not compromise the objectivity of its rating process.

(ix) under paragraph 14 of the COC, representatives of a CRA should be subject to an appropriate rotation mechanism which should provide for gradual change in rating teams.

327. Under paragraph 71 of the COC, a CRA should also ensure that details of its management and rating analyst rotation policy are available to the public on an annual basis

Hong Kong approach to conflict of interests management

328. As regards **management and avoidance of conflicts of interest**, the SFO and its subsidiary legislation, and also the codes and guidelines published by the SFC under the SFO, particularly the COC, set out the framework to identify and eliminate or alternatively manage and disclose conflicts of interest.

329. Paragraphs 29, 30 and 32 of the COC specify that CRAs should establish appropriate and effective organisational arrangements as to prevent, identify and eliminate or manage or disclose conflicts of interest and to be organised in a manner that ensures that they are not affected by business relationships and that the conduct of rating business be separate from any other business.

330. Paragraph 32 of the COC specifically applies to the management of conflict of interests that may influence the ratings the CRA makes and also the judgment and analyses of the representatives, under which:

"A CRA should adopt written internal procedures and mechanisms to (a) identify, and (b) eliminate, or manage and disclose, as appropriate, any actual or potential conflicts of interest that may influence (i) the ratings the CRA makes, or (ii) the judgment and analyses of the representatives who are involved in the preparation of ratings. A CRA's code of conduct (as further described under paragraph 68 of this Code) should also state that the CRA will disclose such conflict avoidance and management measures".

331. As regards **disclosure of the general nature of its compensation arrangements** with the clients from which the CRA receives, paragraph 34(b) of the COC provides that where a CRA or its affiliate that is a credit rating agency receives from a rated entity compensation unrelated to its rating service, a CRA should publicly disclose the proportion that all such compensation constitutes against the total fees that it or its affiliate receives from such rating entity for the provision of ratings services,, and where 5% or more of the CRA's total annual revenue or the CRA's combined annual revenue with its affiliate carrying on credit rating activities is received from a single issuer, originator, arranger, client or subscriber and/or any affiliate of such issuer, originator, arranger, client or subscriber, the CRA should disclose the party or parties from which such revenue is

received.

332. Paragraphs 30 and 34 of the COC set out the requirements that a CRA should have procedures and policies to ensure that the provision of **ancillary services** does not present conflicts of interest with its credit rating activity:

- a CRA should not carry on any business which can reasonably be considered to have potential to give rise to any conflict of interest with the CRA's rating business, and have in place procedures and mechanisms designed to minimize the likelihood that conflicts of interest will arise (COC paragraph 30);
- a CRA should also define what it considers, and does not consider, to be an ancillary business and why it cannot reasonably be considered to have the potential to give rise to any conflict of interest with the CRA's credit rating business (COC paragraph 30);
- the CRA should disclose the proportion that such non-rating fees constitute against the fees the CRA receives from the entity for ratings services (COC paragraph 34(a)).

333. **As regards consultancy or advisory services to rate entity or related third parties,** Paragraph 30 of the COC specifically requires CRA not to provide consultancy or advisory services to a rated entity, or a related party of a rated entity, regarding the corporate or legal structure, assets, liabilities or activities of that rated entity or related party.

334. Paragraphs 36, 63, 66 and 67 of the COC cover the requirements on the arrangements to manage conflict of interests arising from the trading activities and sharing of confidential information by the CRA's representatives and employees.

335. Finally, as regard **prohibition of CRA's employees** i) to buy or sell or engage in transaction supported by any rated entity within the area of primary responsibility of those persons and ii) to take up any key management position with the rated entity or its related third party:

- paragraph 42(b) of the COC provides that no representative or employee of a CRA should prepare (or participate in or otherwise influence the determination of) a rating of any particular rating target if the representative or employee of the CRA:
    - Owns securities or derivatives of the rated entity, other than holdings in collective investment schemes;
    - Owns securities or derivatives of any entity related to a rated entity, the ownership of which may cause, or may be perceived as causing, a conflict of interest, other than holdings in collective investment schemes.
- paragraph 46 of the COC states that a CRA should establish policies and procedures for reviewing the past work of representatives who leave the employ of the CRA and join a rated entity the representative has been involved in rating, or a financial firm with which the representative has had significant dealings as part of his or her duties as a representative or employee of the CRA.

CONFLICT OF INTEREST MANAGEMENT	**BOX3**
Overall, ESMA considers the Hong Kong requirements in terms of conflicts of interest management meet the objectives of the EU requirements. In particular, licensed CRAs are requested to: -establish a general obligation to identify and eliminate or manage and disclose conflicts of interest and to establish organisational and administrative arrangements; - be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities; - identify eliminate or manage and disclose clearly any actual or potential conflicts of interest that may influence the analyses and judgment of ratings analysts; ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity - ensure compensation and performance to be delinked from the amount of revenue they generate - conduct a review when a rating analyst terminates his or her contract joins a rated entity. **Overall, ESMA believes that the objectives of the EU Regulation in the management of conflict of interest section are met by the Hong Kong regulatory framework.**	

IV. **Organisational requirements;**

336. The EU mandate required ESMA to check that as a minimum a CRA keeps records and audit trails of all its activities and has a compliance function which operates independently. In addition, ESMA's approach to assessing the equivalence of the regulation's organisational requirements can be divided into the following areas:

    (i) general organisational requirements;

    (ii) outsourcing;

    (iii) confidentiality;

    (iv) record keeping.

337. The overall objective the organisational requirements is that they contribute to ensuring the objectivity, independence, integrity and quality of the credit rating activities.

Hong Kong approach to organisational requirements

338. With regard to **general organisational requirements**, General SFC Code General Principle 3, General Principle 7 & paragraph 4.3, Internal Control Guidelines Part V and COC paragraph 24 lay down requirements governing:

    (i) the policies and procedures that ensure CRA's compliance of obligations under the SFC's rules and regulation;
    (ii) the implementation and maintenance of sound administrative and accounting procedures, internal control mechanisms, procedures for risk assessment, and control and safeguard arrangements for information processing systems;

(iii) the implementation and maintenance of decision-making procedures and organizational structures that clearly, and in a documented manner, specifying reporting lines and allocating functions and responsibilities;
(iv) the implementation of a permanent and effective compliance function, which operates independently;
(v) the condition under which systems, resources and procedures could be used as to ensure continuity and regularity in the performance of CRA's credit rating activities;
(vi) the monitoring and evaluation of the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with the authorities' requirements and take appropriate measures to address any deficiencies.

339. With regards to **outsourcing of the compliance function**, the Hong Kong regulatory framework requires that CRAs cannot outsource responsibility for compliance with SFC regulatory requirements.

340. More generally, outsourcing is permitted only to the extent that it does not result in a breach of the prohibition (in SFO section 114) on carrying on a business in a regulated activity or performing any regulated function without the appropriate licence. Regulated activity can't be outsourced (section 114 of SFO) meaning that only "back office" functions can be outsourced. A CRA in Hong Kong may outsource those back office functions to its group companies or external professional or consulting firms. However, the CRA and its senior management would remain fully and ultimately responsible for the performance of the compliance function and the outsourced[15].

341. However, an applicant to be a licensed or registered person is required to provide information relating to its human and technical resources, operational procedures and organizational structures, and a business plan covering internal controls, organizational structure, contingency plans and related matters in its application. A licensed or registered person would need to inform SFC of significant changes in internal controls, organizational structure, contingency plans and related matters (Securities and Futures (Licensing and Registration)(Information) Rules section 4 & Schedule 3 Part 1 items 8 & 9).

342. Furthermore, under section 129(2)(c) of the SFO, the SFC may take into account, where such consideration relates to a licence or registration, whether the corporate applicant has established effective internal control procedures and risk management systems to ensure its compliance with all applicable regulatory requirements under any of the relevant provisions.

343. A CRA should institute policies and procedures that clearly specify a person responsible for compliance by the CRA and its employees with the provisions of its code of conduct (as further described under paragraph 68 of the COC) and with any law, rules, regulations, codes or other requirements which apply to the CRA and are issued, administered or enforced by the SFC or any other regulatory authority or agency. This person's reporting lines and compensation should be independent of the CRA's rating operations (Paragraph 24 of the COC).

344. With regard to **confidentiality requirements**, the Hong Kong legal framework covers EU requirement by paragraph 60 and 62 of the CoC both in terms of the scope of the persons subject to the confidentiality requirements or the measures to be established in order to protect all property and records relating to credit rating activities.

345. Paragraph 60 of the CoC requires a CRA to take all reasonable measures to protect confidential

[15] Source: FAQ in respect of outsourcing (SCF website).

information shared with them by issuers under the terms of a confidentiality agreement or otherwise under a mutual understanding that the information is shared confidentially. In addition, Paragraph 66 of the COC provides that a CRA should not share confidential information entrusted to it with employees of any affiliated entities that are not regulated credit rating agencies. Representatives and employees of a CRA should not share confidential information with other representatives or employees of the CRA or of any affiliated entities except on an "as needed" basis and as permitted under any relevant confidentiality agreement.

346. The Hong Kong regulatory framework contains an extensive record-keeping requirements detailed in the COC (paragraph 6) and the "Securities and Futures (Keeping of Records) Rules". Records must be kept at premises approved by the SFC (SFO section 130).

ORGANISATIONAL REQUIREMENTS	**BOX 4**
Overall, ESMA considers the Hong Kong legal and regulatory framework meets the objectives of the EU requirements in respect of the organisational requirements that a licensed CRA needs to have in place in the areas of the general organisational, outsourcing, confidentiality and record keeping.	

V. Quality of methodologies and of ratings

347. As specified in the EU Commission mandate, the objective of this section is to assess the following criteria:

(i) that competent authorities do not interfere with the content of ratings or the CRAs methodologies[16];

(ii) a CRA has a function devoted to the periodical review of methodologies and models;

(iii) A CRA applies consistently the changes in methodologies and models to existing ratings[17];

(iv) a CRA monitors its ratings and methodologies on an on-going basis and at least annually.

Honk Kong approach to quality of rating methodologies and ratings

348. Under the HK CRA Regime, a CRA should establish and implement a rigorous and formal review function responsible for periodically (and at least annually) reviewing (a) the methodologies and models, and significant changes to the methodologies and models, it uses, and (b) the adequacy and effectiveness of its systems and internal control mechanisms.

349. This function should be independent of the business lines that are principally responsible for rating various classes of rating targets. The findings of any such review should be comprehensively recorded in a written report, a copy of which should be provided to the SFC forthwith upon its completion. A CRA should take appropriate measures to address any deficiencies identified during the course of any such review (paragraph 12 of the COC).

[16] As clarified by the SFC to ESMA, the SFC will not interfere with the proper conduct by the CRAs of the business for which they have been licensed in Hong Kong and also has no power to do so under the SFO. Therefore, the SFC is not in a position to interfere with the content of a credit rating report and/or with the rating methodology used by it in the preparation of such report.

[17] Under paragraph 16 of the COC, changes in methodologies, models or key assumptions used in preparing credit ratings should be applied where appropriate to both initial ratings and subsequent ratings. A CRA should review affected credit ratings as soon as possible and not later than six months after the change, and should in the meantime place those ratings under observation.

350. As regards **review of the methodologies and models for determining credit rating of structured finance products**, paragraph 13 of the COC provides that a CRA should assess whether existing methodologies and models for determining credit ratings of structured finance products are appropriate when the risk characteristics of the assets underlying a structured finance product change materially. In cases where the complexity or structure of a new type of structured finance product or the lack of robust data about the assets underlying the structured finance product raise serious questions as to whether a CRA can determine a credible credit rating for it, the CRA should refrain from issuing a credit rating.

351. Similar to the EU requirements, paragraph 5 of the COC requires CRA to use only rating methodologies that are rigorous, systematic, continuous and subject to validation based on experience, including back-testing. When a methodology, model or key ratings assumption used in a credit rating activity is changed, paragraph 16 of the COC provides rules that are similar to the one that exist under the EU CRA Regulation. Accordingly, paragraph 59 of the COC provides that a CRA should immediately disclose the likely scope of credit ratings to be affected by using the same means of communication.

352. With regard to **knowledge and experience for the duties assigned to credit analysts**, the Hong Kong framework (COC paragraphs 7 and 10; SFC's Guidelines on Competence) requires the verification of appropriate knowledge and experience to be achieved by requiring licensed representatives to demonstrate that they meet competence requirements, tests of which include relevant industry experience, holding recognised industry qualifications and passing local regulatory framework papers.

QUALITY OF RATING METHODOLOGIES AND RATINGS	**BOX 5**
Overall, ESMA considers the Hong Kong legal and regulatory framework meets the objectives of the EU requirements in respect of the quality of methodologies and ratings.	

VI. Disclosure of credit rating

353. For the purpose of this advice, ESMA has divided the requirement related to disclosure of credit rating into the following categories:

    (i) the presentation and disclosure of credit ratings, and

    (ii) general and periodic disclosure about CRA.

354. In terms of the disclosure of credit ratings, paragraph 47 of the COC provide that a CRA should, in a timely manner, publicly disclose all ratings and updates of such ratings (or ensure that its affiliate does so), provided that this obligation shall not apply to private ratings within the meaning of paragraph 19 of the COC or to ratings that the CRA (or its affiliate) provides only to subscribers; in the case of ratings that are only provided to subscribers, a CRA should, in a timely manner, disclose all such ratings and updates of such ratings to such subscribers (or ensure that its affiliate does so).

355. Paragraph 18 of the COC also provides that where a rating is made available to the public, the CRA should in a timely manner publicly announce (or ensure that its affiliate publicly announces) if the rating is discontinued and include full reasons for such discontinuation. Where a rating is provided only to subscribers, the CRA should in a timely manner announce (or ensure that its affiliate announces) to such subscribers if the rating is discontinued and include full reasons for such

discontinuation. In both cases, the CRA should ensure that continuing publications of the discontinued rating indicate the date the rating was last updated, the fact that the rating is no longer being updated and include full reasons for its discontinuation.

356. As regards **disclosure of the unsolicited ratings**, the HK CRA Regime provides (paragraph 58 of the COC) that a CRA should state prominently in each credit rating whether or not the rated entity, or any related party of the rated entity, participated in the credit rating process, and (for an unsolicited rating) whether the CRA had access to the accounts and other relevant internal documents of the rated entity or its related party. A CRA should also disclose its policies and procedures regarding unsolicited ratings.

357. Paragraph 55, 57 and 58 of the COC provide that a CRA report must specify the key elements underlying the credit rating, and a CRA should also publish the information on their historical performance data including the ratings transition frequency and information about credit ratings issued in the past and on their changes.

358. Overall, there are a number of provisions that relate to disclosure requirements as follows:

- credit ratings are assigned by the CRA (or its affiliates) and not by any individual representative (paragraph 8 of the COC);
- each of its ratings includes (a) a clear indication of when it was last updated, and (b) a clear and prominent statement identifying the name and job title of the lead rating analyst who is responsible for the rating and the name and the position of the person primarily responsible for approving the ratings (paragraph 49 of the COC);
- credit ratings of debt securities or preferred securities include information on whether the credit rating concerns newly issued debt securities or preferred securities and whether the CRA is rating such securities for the first time (paragraph 49 of the COC);
- each credit rating announcement indicates the principal methodology or methodology version that was used in determining the rating and where a description of that methodology can be found. Where the rating is based on more than one methodology, or where a review of only the principal methodology might cause investors to overlook other important aspects of the rating, the CRA should ensure that this fact is explained in the ratings announcement. Such explanation should include a discussion of how the different methodologies and other important aspects were factored into the rating decision (paragraph 49 of the COC);
- sufficient clear and easily comprehensible information is published about its procedures, methodologies and assumptions (including financial statement adjustments that deviate materially from those contained in the rating target's published financial statements and a description of the rating committee process, if applicable) to enable other parties to understand how a rating was determined. This information should include (but not be limited to) the meaning of each rating category and the definition of default or recovery, and the time horizon the CRA used when making a rating decision (paragraph 50 of the COC).
- all material sources, including the rated entity and, where appropriate, a related party of the rated entity, which were used to prepare the credit rating, are identified. An indication should also be given as to whether the credit rating has been disclosed to the rated entity or to its related party and, following such disclosure, whether the credit rating has been amended before being issued (Paragraph 50 of the COC).

359. As in the EU Regulation, Paragraphs 52 and 53 of the COC encompass additional obligations, regarding ratings on structured finance instruments.

360. In particular, where a CRA rates a structured finance product, it should ensure that the public (in the case of a rating which is made available to the public) or subscribers (in the case of a rating

which is made available only to subscribers) are provided with sufficient information about its loss and cash-flow analysis, and an indication of any expected change in the credit rating, so that an investor with an interest in investing in the product can understand the basis for the rating (paragraph 52 of the COC).

361. A CRA should also ensure disclosure of the degree to which it analyses how sensitive a rating of a structured finance product is to changes in the CRA's underlying rating assumptions (paragraph 52 of the COC).

362. Moreover, a CRA should disclose, on a timely and on-going basis, information concerning all structured finance products submitted to it for its initial review or for a preliminary rating. Such disclosure should be made irrespective of whether the issuer of such a product engages the CRA to provide a final rating (paragraph 52 of the COC).

363. In addition to the above, a CRA should state the level of assessment it has performed concerning the due diligence processes conducted in relation to the underlying finance products, or other assets, of structured finance products. The CRA should disclose whether it has undertaken any assessment of such due diligence processes or whether it has relied on a third-party assessment, indicating how the outcome of such assessment influences the credit rating (paragraph 52 of the COC).

364. Finally, a CRA should differentiate credit ratings of structured financial products from traditional corporate bond credit ratings through a different rating symbology or by using an additional symbol which differentiates them from rating categories for other rating targets, and should also disclose how this differentiation functions.

365. As stated in paragraph 33 of the COC, CRAs have to:

(i) disclose actual or potential conflicts of interest in a complete, clear, concise, specific, prominent and in a timely manner.

(ii) make full public disclosure of its ancillary services and update such disclosure in a timely manner;

(iii) publicly disclose the general nature of its compensation arrangements with rated entities, including:

a. where a CRA or any affiliate of the CRA that is a credit rating agency, receives from a rated entity compensation unrelated to its ratings service, the CRA should disclose the proportion that all such compensation constitutes against the total fees that the CRA, or its affiliate, receives from such rated entity for the provision of ratings services; and

b. where 5% or more of –

i. the CRA's total annual revenue; or

ii. the combined annual revenue of the CRA and any affiliate of the CRA that carries out credit rating activities,

is received from a single issuer, originator, arranger, client or subscriber and/or any affiliate of such issuer, originator, arranger, client or subscriber, the CRA should disclose the party or parties from which such revenue is received (paragraph 34 of the COC).

366. The requirement to disclose a list of CRA's clients in terms of revenue generated from them may not be practical for CRAs' operations within Hong Kong because the Hong Kong entities provide credit rating services to their group companies, which are usually the actual contracting party with their clients.

367. In addition, paragraph 71 of the CoC mandates a CRA to ensure that details of the following information are available to the public on an annual basis:

- the internal control mechanisms designed to ensure the quality of its credit rating activities;
- its record-keeping policy; and
- its management and rating analyst rotation policy.

368. Finally, as regards the **outcome of the internal review**, findings of any such review should be comprehensively recorded in a written report, a copy of which should be provided to the SFC forthwith upon its completion. A CRA should take appropriate measures to address any deficiencies identified during the course of any such review (Paragraph 12 of the CoC).

DISCLOSURE OF CREDIT RATINGS	**BOX 6**
Overall, ESMA considers the HK CRA Regime meets the objectives of the EU requirements in respect of the disclosure of credit ratings.	

VII. Effective supervision and enforcement

369. ESMA considers essential that equivalent supervisory powers than those in place in the EU are embedded in the relevant third country regulatory and legal framework. The necessary competencies are the power to have access to any document, request information from any person, carry out on-site inspections and require records of telephone and traffic data.

370. In addition, the third country needs to be able to take supervisory measures following the establishment of a breach by a CRA.

371. In particular, the SFC has the authority to:

(i) supervise licensed CRAs[18] (this function is performed by the Intermediaries Supervision Department of the SFC[19]);

(ii) in the event of a suspected breach, bring investigation and enforcement action against CRAs (this function is performed by the Enforcement Division of the SFC);

(iii) compel both unregulated and regulated persons to produce information and documents relevant to the investigation, including trade records, bank records, telephone records, internet records and beneficial ownership information (section 183 of the SFO). This power applies to both persons under investigation or whom the SFC has reasonable cause to believe has information relevant to the investigation. In addition, where there is fear of destruction/removal of evidence, flight of target or other concerns, the SFC has the power to access private premises of both un-regulated and regulated persons upon grant of search warrant by a magistrate (section 191 of the SFO).

372. In addition, the SFC has a full range of powers to take criminal, civil, administrative and other

[18] As at the end of February 2013, there were seven licensed CRAs and 220 licensed rating analysts respectively. Currently, the Licensing Department of the SFC has seven teams handling the licensing matters of the seven licensed CRAs respectively, and each team consists of one Director, one Senior Manager and four to five staff members of lower seniority.

[19] Supervision conducted by the Intermediary Supervision Department of the SFC ("ISD") includes both onsite inspection and offsite monitoring. Currently, one Director, one Senior Manager and three to four staff members of lower seniority from ISD are assigned for CRA onsite inspection; and separately, one Director, three Senior Managers and six staff members of lower seniority from ISD are assigned for CRA offsite monitoring.

actions including:

(i) the administrative power to impose disciplinary sanctions against persons licensed or registered with the SFC, including CRAs. Under sections 194 and 196 of the SFO, the SFC has the power to revoke or suspend a licensed or registered person's licence or registration, and to fine (up to a maximum of HK$10 million or 3 times of profit gained/loss avoided, whichever is higher), reprimand or impose prohibitions against the licensed or registered person;

(ii) the power to impose restrictions on licensed or registered persons (including CRAs) as regards its business activities (such as issuing credit ratings) or dealing with assets or maintenance of assets (sections 204 to 210 of the SFO);

(iii) the power to apply to the Hong Kong Court of First Instance for an injunction or other orders (section 211 of SFO) in relation to a failure by a licensed or registered intermediary to comply with a restriction notice issued by the SFC under sections 204 to 210 of SFO;

(iv) the power to apply to the court for injunctive or remedial orders if the court is satisfied that contraventions of the SFO or any conditions of a licence or registration has or may have been committed (section 213 of the SFO);

(v) the power to share non-public information with other domestic regulators and authorities. Under section 378 of the SFO, the SFC can share non-public information with domestic regulators and law enforcement authorities. The SFC has signed a number of MOUs with domestic regulators and authorities;

(vi) the power to make inquiries (concerning any document relating to the business of a licensed or registered person or its associated entity, or concerning any transaction or activity which was undertaken in the course of, or which may affect, the business conducted by the licensed or registered person or its associated entity) of any person whom the SFC has reasonable cause to believe has information relating to, or is in possession of, any such document (SFO section 180(1)(c));

(vii) the power to exchange information with and provide investigatory assistance to overseas regulators (section 186 and 378 of the SFO). The SFC is a signatory to the IOSCO MMOU and also has entered into a significant number of bilateral MOUs with overseas counterparts concerning the sharing of confidential information and investigatory assistance. The SFC is also able to provide investigatory assistance to overseas securities regulators, like obtaining trade records, bank records, telephone records and beneficial owner information; conducting compulsory interviews and take statements on behalf of overseas regulators.

EFFECTIVE SUPERVISION AND ENFORCEMENT **BOX 7**

For the purposes of carrying out its oversight tasks, ESMA considers the HK CRA Regime empowered the SFC with an equivalent range of powers than those in place in the EU.

c) Conclusion on the equivalence status regarding the Hong Kong legislative and regulatory framework

GLOBAL ASSESSMENT	**BOX 8**

ESMA concludes that overall the HK CRA Regime is equivalent to the EU regulatory regime for CRA in terms of what ESMA considers to be the overall objective of:

"assuring that users of ratings in the EU would benefit from equivalent protections in terms of the CRAs integrity, transparency, good governance and reliability of the credit rating activities"

However, only if all the other conditions set out in Article 5(1) of the EU Regulation are met, can a third country credit rating agency be granted certification.

These conditions are that:

-the credit rating agency is authorised or registered in and is subject to supervision in that third country;

-cooperation arrangements are operational;

-the credit ratings issued by the credit rating agency and its credit rating activities are not of systemic importance to the financial stability or integrity of the financial markets of one or more Member States.

Chapter V - Assessments of SINGAPORE

Key to the references and terms used in this advice:

CMS: Capital Markets Services

CRAs: credit rating agencies

MAS: Monetary Authority of Singapore

SFA: Securities and Futures Act

Executive summary

Following ESMA's decision to consider the Singaporean regulatory regime as being in line with the requirements defined in Article 4(3) of the EU Regulation on CRA, this document sets out the technical advice of ESMA in relation to the equivalence between the Singaporean legal and supervisory framework and the EU regulatory regime for credit rating agencies, in accordance with the European Commission's mandate of 12 June 2009.

ESMA concludes that, overall, the Singaporean legal and supervisory framework is equivalent to the EU regulatory regime for credit rating agencies in terms of achieving what ESMA considers to be the overall objective of:

"assuring that users of ratings in the EU would benefit from equivalent protections in terms of the credit rating agencies integrity, transparency, good governance and reliability of the credit rating activities".

In coming to this conclusion, ESMA has verified whether the Singaporean legal and regulatory framework for Credit Rating Agencies met the requirements of the EU Regulation grouped for the purpose of this assessment into seven areas[20], in relation to each of which ESMA has assessed the ability of the Singaporean legal and supervisory framework to achieve the main objectives of the relevant EU requirements. However, only if all the conditions set out in Article 5(1) of the EU Regulation are met, a third country CRA can be granted certification, for example that the CRA is authorised or registered in and is subject to supervision in that third country.

ESMA considers the Singaporean framework to be comprehensive and in many instances similar to the EU Regulation.

There are no areas where the requirements do not meet the objectives of the EU requirements; there are no shortcomings, and (as such) ESMA has no recommendations to make in respect of the legal and supervisory framework as a whole for the purposes of an equivalence determination by the European Commission.

ESMA will keep on monitoring the evolution of the Singaporean legal and supervisory framework for credit rating agencies on an on-going basis and cooperate with the Singaporean Authorities via the Memorandum of Understanding signed with the MAS in this field on 13 March 2012 (ESMA/2012/124). In the event of any future change into the Singaporean regulatory and supervisory regime which may trigger a change in the conclusions of this report, ESMA will appropriately inform the European Commission.

[20] These seven areas are:
1. The scope of the regulatory and supervisory framework
2. Corporate Governance
3. Conflicts of interest management
4. Organisational requirements
5. Quality of methodologies and quality of ratings
6. Disclosure
7. Effective supervision and enforcement.

Assessment of Singapore

373. This section of the report explains how ESMA assesses the equivalence between the Singaporean regulatory and supervisory framework and the EU regulatory regime for credit rating agencies.

374. This section is divided as follows:

a) the Singaporean legal and supervisory framework

b) the assessment of the equivalence on that framework to that of EU

375. This section outlines the general differences between the EU and the Singaporean approach on implementing the credit rating agency registration and oversight regime.

a) The Singaporean legal and supervisory framework

Overall philosophy of approach

376. The Monetary Authority of Singapore (MAS) is the central bank of Singapore and has, inter alia, the responsibility:

- to carry out the monetary policy of Singapore, including oversight of payment systems and serving as banker and financial agent of the Government;
- to conduct integrated supervision of financial services and financial stability surveillance;
- to develop Singapore as an international financial centre.

377. The MAS has the power to issue regulations based on Sections 100 and 341 of the Securities and Futures Act (SFA); those regulations are construed as "subsidiary legislation" and are legally binding having the force of law. MAS Regulations apply to CRAs as Capital Market Services (CMS) licensees, they include the Securities and Futures (Licensing and Conduct of Business) Regulations (SFR (LCB)) and the Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licenses) Regulations (SFR (FM)).

378. The MAS can also impose "conditions or restrictions" when granting a CMS license. Accordingly, the MAS requires CRAs, as CMS licensees, to comply with the provisions of a specific Code of Conduct (CoC), which is legally binding.

379. The mentioned Code of Conduct is based on the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies, but it has been extensively amended. In amending the Code of Conduct, the MAS also took into account what other jurisdictions like Australia and Hong Kong, have implemented.

380. The Singaporean regime fulfils the requirement of having binding supervisory framework for CRAs. The regime for CRAs introduced in January 2012 was elaborated by building on the existing requirements applicable to Capital Market Services (CMS) licensees (similar to what adopted in Australia[21]).

[21] Please refer to the Technical Advice published by ESMA on 18 April 2012 (http://www.esma.europa.eu/system/files/2012_-259_0.pdf).

b) The assessment of the equivalence on Singaporean framework to that of EU

381. An assessment of the regulatory regime adopted in Singapore has been conducted. In carrying out that assessment, ESMA has verified its understanding of the relevant provisions through on-going informal contacts in particular with the MAS.

382. The regime adopted in Singapore has been tested against the objectives pursued by the EU Regulation in the seven areas where it establishes requirements, which are identified in ESMA's Guidelines on Endorsement (ESMA/2011/139, Annex II). These areas are:

(I) the scope of the regulatory and supervisory framework;

(II) corporate governance;

(III) management of conflicts of interest;

(IV) organisational requirements;

(V) quality of methodologies and of ratings;

(VI) general disclosure and presentation of ratings;

(VII) effective supervision and enforcement.

383. As a background to this advice, on 15 March 2012 ESMA informed market participants that it considered the recently adopted regulatory regime for CRAs in Singapore embeds requirements which follow closely those in place in the EU. As a consequence, the regulatory regime in Singapore is assessed as fulfilling the "as stringent as" test set out in Article 4(3) (b) of Regulation No 1060/2009.

I. <u>The scope of the regulatory and supervisory framework</u>

384. On 17 January 2012, MAS implemented the regulatory regime for CRAs where "providing credit rating services" has been included as a regulated activity into the existing supervisory regime provided under the SFA. On the same day, the Code of Conduct for Credit Rating Agencies was also published. Any person who carries on or holds himself out as carrying on the business of "providing credit rating services" will be required to hold a capital markets services ["CMS"] licence under s.82 of the SFA.

385. There was a transition period of 6 months for existing CRAs to apply for the licence. All three CRAs operating in Singapore (namely Moody's Investors' Services Singapore Pte Ltd, Standard & Poor's Singapore Pte Ltd and Fitch Ratings Singapore Pte Ltd were licensed for providing credit rating services under the SFA on 27 April 2012.

386. Under the Singaporean regime, CRAs need to apply for a CMS licence to carry on business in "providing credit rating services" in Singapore. An applicant for a CMS licence must submit the

information required in Form 1 (Application for a Capital Markets Services Licence under section 84(1) read with regulation 6A and regulation 4A(3)), together with the relevant supporting documents and information. The required information includes:

(i) Information on the applicant

(ii) Information on directors and shareholders

(iii) Information on group structure

(iv) Information on whether the applicant meets the fit and proper criteria

(v) Information on the location of the register of securities

387. The minimum licensing admission criteria for persons applying for a CMS licence are set out in the Guidelines on Criteria for the Grant of a Capital Markets Services Licence other than for Fund Management (SFA 04-G01):

General Criteria for the Grant of a CMS Licence;

(i) A CMS licence is only to be granted to a corporation[22];

(ii) The applicant is a reputable entity that has an established track record in the proposed activity to be conducted in Singapore or in a related field, for at least the past 5 years;

(iii) The applicant and its holding company or related corporation, where applicable, has good ranking in its home country;

(iv) Where applicable, the applicant is subject to proper supervision by its home regulatory authority;

(v) The applicant satisfies the MAS that it will discharge its duties efficiently, honestly and fairly;

(vi) The applicant establishes and operates out of a physical office in Singapore;

(vii) The applicant is primarily engaged in the business of conducting any one of the regulated activities specified in the Second Schedule to the SFA;

(viii) The applicant, its officers, employees, representatives and substantial shareholders are fit and proper, in accordance with the criteria set out in the Guidelines on Fit and Proper Criteria issued by MAS.

388. As regards the scope of the definition of CRAs, as provided by the SFA, it covers credit rating services provided to the public (through publication or via subscription. In particular, under the Singapore regime, "providing credit rating services" means preparing, whether wholly or partly in Singapore, credit ratings in relation to activities in the securities and futures industry for:

(i) dissemination, whether in Singapore or elsewhere, or with a reasonable expectation that they will be so disseminated; or

(ii) distribution by subscription, whether in Singapore or elsewhere, or with a reasonable expectation that they will be distributed.

389. Similar to the EU requirements, the definition of CRAs does not include:

(i) preparing a private credit rating pursuant to an individual order which is intended to be

[22] Under the Singapore framework, CRAs that are CMS licensees shall take the legal form of a corporation (legal personality).

provided exclusively to the person who placed the order and not intended for public disclosure or distribution by subscription; or

(ii) preparing credit scores, credit scoring systems or similar assessments related to obligations arising from consumer, commercial or industrial relationships.

390. The MAS is entitled to issue regulations based on Sections 100 and 341 of the SFA. These regulations are construed as "subsidiary legislation" and have the force of law. As a consequence, a breach to their provisions may constitute an offence where it is provided in the regulations and that can trigger administrative or criminal proceedings.

391. These Regulations, being applicable to CRAs as CMS licensees, include the Securities and Futures (Licensing and Conduct of Business) Regulations (SFR (LCB)) and the Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licenses) Regulations (SFR (FM)) which collectively require CRAs to comply with ongoing business conduct requirements.

392. In accordance with Section 88 of the SFA, the MAS can also impose "conditions or restrictions" when granting a CMS license. Accordingly, the MAS requires CRAs, as CMS licensees, to comply with the provisions of a specific Code of Conduct. Non-compliance with the Code of Conduct is a contravention of a licence condition, which constitutes an offence under Section 88 of the SFA.

393. Furthermore, MAS has powers to inspect a CMS licensee under section 150(1) SFA. An entity inspected by MAS shall allow full access to its books, accounts and documents and shall give such information and facilities (as may be required to conduct the inspection).

394. Finally, MAS does not have the legal powers to interfere with or influence CRAs' rating methodologies or the content of CRAs' ratings.

SINGAPORE'S LEGAL AND REGULATORY FRAMEWORK FOR CRA **BOX 1**

In light of the above, it is considered that that the scope of the regulatory and supervisory framework Singapore that was adopted in January 2012, has a comprehensive and legally binding framework in relation to CRAs supervision and licencing requirements.

Overall, it is clear that both the EU and Singaporean regimes share the same overall objectives namely, to ensure that CRA ratings are carried out fairly and from an independent standpoint.

II. Corporate governance

395. The EU mandate on assessing the equivalence between certain non-EU countries and the EU regulatory regime for CRAs required ESMA to at least check that "two independent directors of the CRA's administrative or supervisory board are tasked with monitoring the credit rating policies, effectiveness of the internal quality control system as well as the internal controls and measures established to deal with conflicts of interest".

Singapore's approach to corporate governance

396. Corporate governance objectives are achieved through the requirements concerning reporting to the board by the compliance function and, in particular, by the independent internal review function.

397. Similar to approach taken by other jurisdictions, the objectives of this requirement are achieved

through the rules governing, and the obligations to be discharged by, the independent internal review function. This function has an important role in ensuring the effectiveness of the independent oversight on various credit rating activities performed by the CRAs.

398. Ultimate responsibility for the proper implementation of an internal review function would fall on the CEO and directors of a CRA. This reflects the fact that failure to implement and ensure compliance with written policies on the internal review function would render the CEO and directors liable to be removed from their offices if MAS is satisfied that they have thereby failed to discharge their duties or functions and their removal is necessary in the public interest or for the protection of investors.

399. CRAs are also required to seek MAS' approval under section 96(1) of the SFA for the appointment of a CEO or any director. MAS takes into consideration various criteria including the individual's experience, expertise and past performance when determining whether to grant the approval (Reg. 12(2) of SFR (LCB)). MAS expects a CEO and a director of a CMS licensee to discharge the duties or functions of his office. These are outlined in Regulation13 of SFR(LCB). Under section 97(1) of the SFA, MAS has power to remove an office holder if MAS is satisfied that he/she has failed to discharge his/her duties or functions of this office.

400. Under section 97(1)(c) read with section 97(2), MAS has the power to direct the removal of an officer of a licensed CRA if it is satisfied that the officer (including the CEO and directors of the CRA) fails to discharge his/her duties or functions according to such criteria as MAS may prescribed. The criteria that the MAS would consider in determining whether an officer has failed in discharging his/her duties or functions are prescribed in Regulation 13 of the SFR(LCB).

401. Under Section 97(2) of the Act and Regulation 13 of the SFR(LCB), the directors of a CRA shall make sure they have:

(i) implemented, and ensured compliance with, effective written policies on all operational areas of the CRA, including the CRA's financial policies, accounting and internal controls, internal auditing and compliance with all laws and rules governing the CRA's operations;

(ii) put in place compliance function and arrangements that are commensurate with the nature, scale and complexity of the business of the CRA, including specifying the roles and responsibilities of officers and employees of the CRA in helping to ensure its compliance with all applicable laws, codes of conduct and standards of good practice in order to protect investors and reduce its risk of incurring legal or regulatory sanctions, financial loss, or reputational damage;.

(iii) identified, addressed and monitored the risks associated with the business activities of the CRA;

(iv) ensured that the business activities of the CRA are subject to adequate internal audit;

(v) ensured that the internal audit of the CRA or the CRA's holding company (if any) includes inquiring into the CRA's compliance with all relevant laws and all relevant business rules of any securities exchange, futures exchange and clearing house;

(vi) set out in writing the limits of the discretionary powers of each officer, committee, sub-committee or other group of persons of the CRA empowered to commit the CRA to any financial undertaking or to expose the CRA to any business risk (including any financial, operational or reputational risk);

(vii) kept a written record of the steps taken by the CRA to monitor compliance with its policies, its accounting and operating procedures, and the limits on discretionary powers;

(viii) ensured the accuracy, correctness and completeness of any report, book or statement submitted by the CRA to its head office (if any) or to the Authority; and

(ix) ensured effective controls and segregation of duties to mitigate potential conflicts of interest that may arise from the operations of the CRA

402. In order to be licensed, the CRAs have to demonstrate that the CRA and all of its officers, employees and (substantial) shareholders are "fit and proper". In case this requirement should not be met, the MAS may refuse an application for a CMS license.

403. Finally, the combination of paragraph 14(b) of the Guidelines on Fit and Proper Criteria (to avoid conflicts of interests) and those requiring the approval from the MAS of the appointment of the CRA's directors provide additional comfort in this area.

CORPORATE GOVERNANCE **BOX 2**

Overall, corporate governance is an adequate building block of the Singaporean regime for CRAs. ESMA considers that the requirements that are in place meet the objectives of this section on the basis of the following:
- there is a general obligation for the CRAs, its officers and staff to fulfil their tasks from an independent standpoint;
- effective independence of Board members is achieved through specific policies and is to be demonstrated to the MAS

Overall, although the MAS requirements that apply in respect of the corporate governance follow a different approach, ESMA believes that the objectives of the EU- Regulation in the corporate governance section are met by the Singaporean regulatory framework.

III. Conflict of interest Management

404. The EU mandate required ESMA to check at least the following issues in this section:

(i) a CRA identifies and eliminates (or manages and discloses) conflicts of interest;

(ii) a CRA ensures that business interest does not impair the independence and accuracy of ratings;

(iii) a CRA does not provide consultancy or advisory services;

(iv) A CRA refrains from issuing a rating when it has direct or interest in the entity asking for a rating;

(v) rating analysts cannot make proposals or recommendations on the design of structured finance products;

(vi) rating analysts are not involved on the negotiation of the fees or payments with any rated entity, related third parties or any person directly or indirectly linked with the rated entity by control;

(vii) rating analysts compensation and performance evaluation is de-linked from the revenue they generate from the CRA;

(viii) a stringent rotation policy is put in place;

Singapore's approach to conflict of interests management

405. The subject is mainly dealt with through principles and safeguards embedded in the CRA Code set forth by the MAS. Reg 13(b)(ix) of the SFR(LCB) also requires a CRA to ensure effective controls and segregation of duties to mitigate potential conflicts of interest that may arise from the CRA's operations.

406. Para 6.1 of the Code of Conduct requires CRAs to adopt and implement written procedures and mechanisms to

(i) identify, and

(ii) eliminate, or manage and disclose, as appropriate, any actual or potential conflicts of interest that may influence the credit ratings a CRA makes or the judgment and analyses of its representatives on the CRA's credit ratings decisions. A CRA's internal code of conduct (as described in paragraph 10.1 of this Code) should also state that the CRA will publicly disclose such conflict avoidance and management measures.

407. Besides, paragraph 5.4 to 5.8 of the Code sets forth an overarching provision ensuring that:

(i) the CRA's credit ratings are not affected by the existence of or potential for a business relationship between the CRA (or its affiliates) and any rated entity (or its affiliates) or any other party, or the non-existence of such a relationship;

(ii) the CRA does not provide consultancy or advisory services to a rated entity or a related party of the rated entity regarding the corporate or legal structure, assets, liabilities or activities of that rated entity or its related party.

(iii) the CRA does not carry on any business, including consulting or advisory businesses, which can reasonably be considered to have the potential to give rise to any conflict of interest in relation to the carrying on of its business of providing credit rating services;

(iv) CRA's ancillary business operations which do not necessarily present conflicts of interest with the CRA's credit rating business have in place procedures and mechanisms designed to minimise the likelihood that conflicts of interest will arise. A CRA should also define what it considers to be an ancillary business and why it cannot reasonably be considered to have the potential to give rise to any conflict of interest with the CRA's credit rating business;

(v) the CRA does not enter into any contingent fee arrangement for providing credit rating services. For the purpose of this paragraph, a contingent fee is a fee the amount of which is determined by reference to the outcome of a transaction or the result of services provided by the CRA.

408. With regard to independence of judgment of rating analyst, Paragraph 7.1 of the CRA Code requires that the reporting lines for CRA's representatives and employees and the compensation arrangements of the representatives and employees be structured to eliminate or effectively manage actual and potential conflicts of interest.

409. Furthermore, a CRA's internal code of conduct (as described in paragraph 10.1 of the CRA Code) should state that a representative will not be compensated or evaluated on the basis of the amount of revenue that the CRA derives from rated entities of the credit ratings that the representative rates or with which the representative regularly interacts (paragraph 7.2 of the CRA Code).

410. In this regard, CRAs should conduct formal and periodic reviews of compensation policies and

practices for its representatives and employees who participate in or who might otherwise have an effect on the credit rating process to ensure that these policies and practices do not compromise the objectivity of the CRA's credit rating process (Paragraph 7.3 of the CRA Code).

411. The Singapore regulatory framework sets out additional rules for prohibiting analysts and employees to influence or determine ratings as follows:

(i) representatives who are directly involved in credit rating activities do not initiate, or participate in, discussions regarding fees or payments with any rated entity or potential rated entity (Paragraph 7.4 of CRA Code);

(ii) no representative or employee of a CRA should participate in the credit rating activities or otherwise influence the determination of a credit rating of any particular rating target if the representative or employee:

- owns securities or derivatives of the rated entity, other than holdings in diversified collective investment schemes;
- owns securities or derivatives of any entity related to a rated entity, the ownership of which may cause or may be perceived as causing a conflict of interest, other than holdings in diversified collective investment schemes;
- has had a recent employment or other significant business relationship with the rated entity that may cause or may be perceived as causing a conflict of interest;
- has an immediate family member who currently works for the rated entity; or
- has, or had, any other relationship with the rated entity or any related party thereof that may cause or may be perceived as causing a conflict of interest (Paragraph 7.5 of the CRA Code).

(iii) a CRA should prohibit its representatives and employees from soliciting money, gifts or favours from anyone with whom the CRA conducts business and should prohibit its representatives and employees from accepting gifts offered in the form of cash or any gifts exceeding a minimal monetary value (Paragraph 7 .8 of the CRA Code).

(iv) a CRA should establish policies and procedures for reviewing the past work of representatives that leave the employ of or engagement with the CRA and join a rated entity that the representative has been involved in preparing, issuing or revising a credit rating, or a financial firm with which the representative has had significant dealings as part of his duties at the CRA (Paragraph 7.10 of the CRA Code). .

(v) paragraph 6.5 of the CRA Code provides that a CRA should publicly disclose if it or any of its affiliates receives 5 percent or more of its annual revenue from a single issuer, originator, arranger, client or subscriber, of securities (including any affiliates of that issuer, originator, arranger, client or subscriber).

412. **As regards ancillary services**, a CRA should ensure that operations which do not necessarily present conflicts of interest with the CRA's credit rating business have in place procedures and mechanisms designed to minimise the likelihood that conflicts of interest will arise.

413. A CRA should also define what it considers to be an ancillary business and why it cannot reasonably be considered to have the potential to give rise to any conflict of interest with the CRA's credit rating business (Paragraph 5.7 of the Code of Conduct).

414. As regards the **internal control procedures and mechanisms**, a CRA should put in place a rigorous and formal function to periodically review the rating methodologies and models and the

adequacy and effectiveness of its systems and internal control mechanisms (Paragraph 2.11 of the CRA Code).

415. With regard to **gradual rotation** of credit analysts and persons approving credit ratings, paragraph 2.13 of the Code of conduct specifies that a CRA should structure its rating teams to promote continuity and avoid bias in the credit rating process. Where feasible and appropriate for the size and scope of its credit rating services, a CRA should establish an appropriate gradual rotation mechanism for its representatives which should provide for rotation in phases on the basis of individuals rather than the entire rating team.

CONFLICT OF INTEREST MANAGEMENT **BOX 3**

Overall, ESMA considers the Singaporean requirements in terms of conflicts of interest management meet the objectives of the EU requirements.

In particular, CRA is requested to:

- establish a general obligation to identify and eliminate or manage and disclose conflicts of interest and to establish organisational and administrative arrangements;

- be organised in a manner that ensures that its business interest does not impair the independence and accuracy of its credit rating activities;

- identify eliminate or manage and disclose clearly any actual or potential conflicts of interest that may influence the analyses and judgment of ratings analysts;

- ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activity

- ensure compensation and performance to be delinked from the amount of revenue they generate

- conduct a review when a rating analyst terminates his or her contract joins a rated entity.

Finally, with regard to the establishment of a gradual rotation mechanism for rating analysts, ESMA considers that, as a whole, the Singaporean framework meets the same objectives as the EU Regulation.

Overall, ESMA believes that the objectives of the EU Regulation in the management of conflict of interest section are met by the Singaporean regulatory framework.

IV. **Organisational requirements;**

416. The EU mandate required ESMA to check that as a minimum a CRA keeps records and audit trails of all its activities and has a compliance function which operates independently. In addition, ESMA's approach to assessing the equivalence of the regulation's organisational requirements can be divided into the following areas:

(i) general organisational requirements

(ii) outsourcing

(iii) confidentiality

(iv) record keeping.

417. The overall objective the organisational requirements is that they contribute to ensuring the objectivity, independence, integrity and quality of the credit rating activities.

Singapore's approach to organisational requirements

418. With regard to **general organisational requirements**, the chief executive officer (CEO) and directors of a CRA are required to ensure the CRA's compliance with all laws and rules governing the CRA's operations.

419. Singapore's legal framework includes a variety of provisions for requiring that a CRA establishes **adequate policies and procedures to ensure compliance** of CRA's obligations under all applicable laws, rules, codes of conduct and standards of good practice (Regulation 13(b)(i) and (b)(ii) of the SFR(LCB), paragraph 4.5 of the CRA Code) including:

(i) the implementation of effective written policies on all operational areas of the CRA, including the CRA's financial policies, accounting and internal controls, internal auditing and compliance with all laws and rules governing the CRA's operations (Regulation 13(b)(i) of the SFR(LCB);
(ii) the establishment of a compliance function and arrangements that are commensurate with the nature, scale and complexity of the business of the CRA, including specifying the roles and responsibilities of officers and employees of the CRA in helping to ensure its compliance with all applicable laws, codes of conduct and standards of good practice in order to protect investors and reduce its risk of incurring legal or regulatory sanctions, financial loss, or reputational damage (Regulation 13(b)(ii) of the SFR(LCB);
(iii) the establishment of policies and procedures that clearly specify a person ("compliance officer") to be responsible for compliance by the CRA, and compliance by its representatives and employees, with any law, regulations, notices, conditions, codes, guidelines or other requirements which are imposed on and apply to the CRA (paragraph 4.5 of the CRA Code).

420. With regard to the **obligation for CRAs to have sound administrative and accounting procedures, internal control mechanisms, procedures for risk assessment, and control and safeguard arrangements for information processing systems**, Singapore's legal framework includes a variety of provisions including the obligation :

(i) to have sound procedures relating to the keeping of books and audits (section 102(1)(a) and (b) of the SFA);
(ii) to put in place compliance function and arrangements that are commensurate with the nature, scale and complexity of the CRA's business (Regulation 13(b)(ii) of SFR(LCB) Regulation);
(iii) to identify, address and monitor the risks associated with the CRA's business activities (Regulation 13(b)(iii) of the SFR(LCB));
(iv) to have effective control and safeguard arrangements for information processing systems (Paragraph 2.11 of the CRA Code);
(v) to implement and maintain decision-making procedures and organisational structures, which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities (Paragraph 2.7 of the CRA Code);
(vi) to employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of its credit rating activities (Paragraph 2.13 of the CRA Code);
(vii) to put in place rigorous and formal function to periodically review the rating methodologies and models and the adequacy and effectiveness of its systems and internal control mechanisms (Paragraph 2.11 of the CRA Code);

(viii)to monitor compliance with its policies through proper record keeping and internal audit. (Regulation 13(b)(v) and (vii) of the SFR(LCB))

421. **With regard to outsourcing**, MAS expects all CMS licensees, including CRAs, to follow the prudent practices on risk management as set out in the Guidelines on Outsourcing when they engage in outsourcing (paragraph 2.3 of MAS Guidelines). Besides, Annex 1 of the MAS Guidelines on outsourcing lays down the guidance for CRAs with regard to the activities that are considered as outsourced.

422. With regard to the **confidentiality requirements**, the Singapore legal framework covers EU requirement by specific provisions of the CRA Code both in terms of the scope of the persons subject to the confidentiality requirements (Paragraph 9.6 of the CRA Code) and the measures to be established in order to protect all property and records relating to credit rating activities (Paragraph 9.3 of the CRA Code). Paragraph 9.7 of the CRA Code requires a CRA to ensure that confidential information are only shared with affiliated CRAs and employees thereof on a need-to basis and in accordance with any relevant confidentiality agreements.

423. Moreover, under the CRA Code, representatives and employees of CRAs possessing confidential information concerning issuers of securities are **prohibited from engaging in transactions in such securities or for any purpose other than providing credit rating services** (Para 9.4 and 9.8 of the CRA Code).

424. The Singaporean regulatory framework contains **record-keeping requirements** detailed in Para 2.6 of the CRA Code. Overall, a CRA should maintain records to support every credit rating issued and keep them for at least 6 years from the issue date of every credit rating.

ORGANISATIONAL REQUIREMENTS	**BOX 4**
Overall, ESMA considers the Singaporean legal and regulatory framework meets the objectives of the EU requirements in respect of the organisational requirements that a credit rating agency needs to have in place in the areas of the general organisational, outsourcing, confidentiality and record keeping.	

V. Quality of methodologies and of ratings

425. As specified in the EU commission mandate, the objective of this section is to assess the following criteria:

(i) that competent authorities do not interfere with the content of ratings or the CRAs methodologies

(ii) a CRA has a function devoted to the periodical review of methodologies and models

(iii) A CRA applies consistently the changes in methodologies and models to existing ratings

(iv) a CRA monitors its ratings and methodologies on an on-going basis and at least annually

Singapore's approach to quality of rating methodologies and ratings

426. Paragraph 2.11 of the CRA Code requires CRAs to put in place rigorous and formal function to

periodically review the rating methodologies and models including reviewing key rating assumptions and the adequacy and effectiveness of its systems and internal control mechanisms.

427. According to paragraph 3.2 of the CRA Code, subsequent monitoring should incorporate all cumulative experience obtained. Changes in methodologies, models and key rating assumptions relevant to a credit rating should be applied where appropriate to both the initial credit rating and subsequent credit ratings. A CRA should review affected credit ratings as soon as possible and in any case, not later than 6 months after the change and should place those credit ratings under observation before the review is carried out.

428. In addition, CRAs are also required to monitor its ratings and methodologies on an on-going basis and at least annually and that adequate manpower and financial resources are allocated to monitor and update its credit ratings (paragraph 2.11 and 3. 1 of the CRA Code).

429. Similar to the EU requirements, CRAs are required to adopt and implement written procedures to ensure that credit ratings are prepared based on thorough analysis of all information known to the CRAs that is relevant to its analysis according to the CRAs' published rating methodology (Paragraph 2.1 of the CRA Code).

430. Moreover, paragraph 2.13 of the CRA Code provide that a CRA must ensure continuity and regularity and avoid bias in the credit rating process, while Paragraph 2.12 requires a CRA to assess whether existing methodologies and models for determining credit ratings of structured finance products are appropriate when the risk characteristics of the assets underlying a structured finance product change significantly.

431. With regard to the quality of information used for assigning credit ratings, the CRA Code requires CRAs to disclose the extent to which they have examined the quality of information used in the credit rating process and whether they are satisfied with the quality of information they base their credit ratings on (paragraphs 2.5 and 8.7 of the CRA Code).

432. In terms of whether the quality of the information that a CRA uses in assigning a credit rating is of sufficient quality and from reliable sources, Paragraph 2.9 of the CRA Code requires CRA to adopt reasonable measures so that the information used in assigning a credit rating is of sufficient quality to support a credible credit rating.

433. The CRA Code also provides that, where feasible and appropriate, CRAs will be required to establish an appropriate gradual rotation mechanism for its representatives in phases based on an individual rotation (paragraph 2.13 of the CRA Code) and to ensure that details of the management and representative rotation policy are made available to the public on an annual basis (paragraph 10.4 of the CRA Code).

434. Finally, with regard to the knowledge and experience for the duties assigned to credit analysts, the Singaporean framework (Paragraph 2(8) of the CRA Code) requires CRAs to ensure that persons who act as their representatives have, individually and collectively (particularly where rating committees are used) the appropriate knowledge and experience in developing a credit rating for the type of credit being applied (para. 2.8 of the CRA Code).

QUALITY OF RATING METHODOLOGIES AND RATINGS **BOX 5**

Overall, ESMA considers the Singaporean legal and regulatory framework meets the objectives of the EU requirements in respect of the quality of methodologies and ratings.

VI. **Disclosure of credit rating**

435. For the purpose of this advice, ESMA has divided the requirement related to disclosure of credit rating into the following categories:

(i) the presentation and disclosure of credit ratings, and

(ii) general and periodic disclosure about CRA.

436. Except for private credit ratings provided only to the issuer, CRAs are required to disclose to the public, on a non-selective basis and in a timely manner, any credit rating regarding publicly issued securities, or public issuers themselves, as well as any subsequent decisions to discontinue such a credit rating (paragraph. 8.5 of the CRA Code).

437. CRAs are required to ensure that they do not represent or imply or knowingly permit to be represented or implied in any manner to any person that the CRA's abilities or qualifications have in any respect been approved by the MAS (Regulation. 46A of the SFR (LCB)).

438. CRAs are required to disclose with regard to the credit rating whether the rated entity or any related party of the rated entity participated in the process of the credit rating and (in the case of an unsolicited rating) whether the CRA had access to the accounts and other relevant internal documents of the rated entity or its related party (paragraph 8.15 of the CRA Code). CRAs are required to identify unsolicited credit ratings as such and to disclose its policies and procedures regarding unsolicited credit ratings (paragraph 8.15 of the CRA Code).

439. CRAs are required to publish the following:

(i) with regard to their press releases or credit rating reports, CRAs have to explain the key elements underlying the credit rating (paragraph. 8.12 of the CRA Code);

(ii) sufficient information about the historical default rates of the rating categories and whether the default rates of these rating categories have changed over time (paragraph 8.14 of the CRA Code);

(iii) a clear and prominent statement identifying the name and job title of the representative who is primarily responsible for the credit rating, and the name and the position of the person primarily responsible for approving that credit rating (paragraph 8.3 of the CRA Code);

(iv) all material sources which were used to produce, assign, issue or revise the credit rating (paragraph 8.6 of the CRA Code)

(v) in each credit rating announcement, the principal rating methodology or methodology version that was used in determining the credit rating and where a description of that rating methodology can be found (paragraph 8.4 of the CRA Code);

(vi) sufficient and clear information about the meaning of each rating category and the definition of default or recovery (paragraph 8.16 of the CRA Code);

(vii) in relation to each credit ratings, a clear indication of when the credit rating was first distributed and when it was last updated (paragraph 8.3 of the CRA Code);

(viii) the extent to which it has examined the quality of information used in the credit rating process and whether it is satisfied with the quality of information it bases its credit rating on. (paragraph 8.7 of the CRA Code);

(ix) the attributes and limitations of each credit rating and the limits to which the CRA verifies information provided to it by the rated entity (paragraph 8.11 of the CRA Code);

440. As in the EU Regulation, the Singapore legal and Regulatory framework encompasses additional obligations, regarding ratings on structured finance instruments. In particular, a CRA must:

(i) differentiate credit ratings of structured finance products from credit ratings of traditional corporate bond, preferably through a different rating symbology. (paragraph 8.10 of the CRA Code)

(ii) publicly disclose how this differentiation is done. A CRA should clearly define a given rating symbol and apply it in a consistent manner for all types of securities to which that symbol is assigned (paragraph 8.10 of the CRA Code);

(iii) disclose, on a timely and ongoing basis, information concerning all structured finance products submitted to it for its initial review or for a preliminary credit rating. Such disclosure should be made irrespective of whether the issuer of such a structured finance product engages the CRA to provide a final credit rating. (paragraph 8.9 of the CRA Code)

(iv) state the level of assessment performed concerning the due diligence processes conducted in relation to the underlying finance products, or other assessment of the structured finance products (paragraph 8.9 of the CRA Code).

(v) disclose whether it has undertaken any assessment of such due diligence processes or whether it has relied on a third-party assessment, indicating how the outcome of such assessment influences the credit rating." (paragraph 8.9 of the CRA Code)

(vi) disclose sufficient information about its loss and cash-flow analysis so that an investor in the product can understand the basis for the CRA's credit rating, and an indication of any expected change in the credit rating. A CRA should also publicly disclose the degree to which it analyses how sensitive a credit rating of a structured finance product is to changes in the CRA's underlying rating assumptions (paragraph 8.8 of the CRA Code);

441. With regard to **general disclosure**, under the CRA Code of Conduct (Paragraphs 6.2, 8.2, 8.14, 8.16 to 8.17, and 10.1 of the CRA Code), a CRA is required to publish:

(i) any actual or potential conflicts of interest that may arise in relation to the carrying on of its business of providing credit rating services. Such disclosures should be complete, clear, concise, specific and prominent and should be made in a timely manner.

(ii) a list of all its ancillary businesses and update the list in a timely manner whenever there is any change thereto.

(iii) its policies for distributing credit ratings, reports and updates

(iv) any material modification to its methodologies, models, key rating assumptions and significant practices, procedures, and processes.

(v) its internal code of conduct together with a description of how the provisions of its internal code of conduct fully implement the provisions of this Code;

(vi) how the CRA intends to enforce its internal code of conduct and should disclose on a timely basis any changes to its internal code of conduct and how it is implemented and enforced;

(vii) sufficient information about the historical default rates of the CRA's rating categories and whether the default rates of these rating categories have changed over time.

442. In terms of annual disclosure, the following information is to be submitted to the MAS:

(i) a list of the licensee's largest 20 clients by revenue generated of them;

(ii) a list of the licensee's clients whose contribution to the growth rate in the generation of revenue of the licensee in the previous financial year exceeded the growth rate in the total revenues of the licensee in that year by a factor of more than 1.5 times;

(iii) the outcome of the internal review of its independence compliance function; and

(iv) statistics of:

- staff allocation to new credit ratings;
- credit rating reviews;
- methodology or model appraisal; and
- senior management.

443. Finally, the CRA is also requested to disclose its policies and procedures regarding record-keeping, internal control mechanisms to ensure the quality of its credit rating activities; quality control system, management and representative rotation policy and details of its legal structure, ownership and financial information about its revenue (paragraph 10.4 of the CRA Code).

DISCLOSURE OF CREDIT RATINGS **BOX 6**

Overall, ESMA considers the Singaporean legal and regulatory framework meets the objectives of the EU requirements in respect of the disclosure of credit ratings.

VII. **Effective supervision and enforcement**

444. ESMA considers essential that equivalent supervisory powers than those in place in the EU are embedded in the relevant third country regulatory and legal framework. The necessary competencies are the power to have access to any document, request information from any person, carry out on-site inspections and require records of telephone and traffic data.

445. In addition, the third country needs to be able to take supervisory measures following the establishment of a breach by a CRA.

446. Globally speaking, under the Singaporean legal and regulatory framework (Section 82 of the SFA; and the Second Schedule to the SFA), the MAS has the staff, powers, expertise and resources to conduct effective regulation of CRAs.

447. With regard to its internal organisation, the Investment Intermediaries Department within the Capital Markets Group is responsible for the supervision of CRAs. MAS conducts annual reviews of its work plan and resources to ensure that it is well staffed with regard to expertise and capacity to discharge its functions.

448. In particular, the MAS will have authority to:

(i) inspect a CMS licensee under s.150(1) SFA. An entity inspected by MAS shall allow full access to its books, accounts and documents and shall give such information and facilities as may be required to conduct the inspection. MAS has powers to make copies or take possession of any of the books produced;

(ii) invoke investigation powers to require production of documents under section 163 of the SFA;

449. In addition, MAS has the powers to perform the following:

(i) issue written instructions to a CRA under s.101 of the SFA;

(ii) revoke the licence of a CRA under s.95(2) of the SFA or to suspend the activities of CRA under s.95(3) of the SFA on the grounds stated in s.95(2) of the SFA;

(iii) publish information relating to any breach by a CRA of its regulatory obligations.

(iv) refer matters to the relevant national authorities (such as the Commercial Affairs Department of the police and the Attorney General's Chambers) for criminal investigation and prosecution.

EFFECTIVE SUPERVISION AND ENFORCEMENT	**BOX 7**
For the purposes of carrying out its oversight tasks, ESMA considers the Singaporean legal and regulatory framework empowered the MAS with an equivalent range of powers than those in place in the EU.	

c) Conclusion on the equivalence status regarding the Singaporean legislative and regulatory framework

GLOBAL ASSESSMENT	**BOX 8**

ESMA concludes that overall the Singaporean legal and supervisory framework is equivalent to the EU regulatory regime for CRA in terms of what ESMA considers to be the overall objective of:

"assuring that users of ratings in the EU would benefit from equivalent protections in terms of the CRAs integrity, transparency, good governance and reliability of the credit rating activities"

However, only if all the other conditions set out in Article 5(1) of the EU Regulation are met, can a third country credit rating agency be granted certification.

These conditions are that:

a) the credit rating agency is authorised or registered in and is subject to supervision in that third country;

b) cooperation arrangements are operational;

c) the credit ratings issued by the credit rating agency and its credit rating activities are not of systemic importance to the financial stability or integrity of the financial markets of one or more Member States.