Technical Advice

Competition, choice and conflicts of interest in the credit rating industry

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Table of Contents

Acronyms used

CEREP	Central repository of credit rating data reported to ESMA by credit rating agencies
Commission	The European Commission
CRAs	Credit rating agencies
EBA	European Banking Authority
ECAF	Eurosystem Credit Assessment Framework
ECAI	External Credit Assessment Institution
ECB	European Central Bank
EIOPA	European Insurance and Occupational Pensions Authority
ESAs	European Supervisory Authorities
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
IOSCO	International Organization of Securities Committees
ITS	Implementing Technical Standards
NCA	National Competent Authorities
SCA	Sectoral Competent Authorities
SFI	Structured Finance Instruments
SMEs	Small and medium-sized enterprises
US	United States of America

1 Executive summary

1. This Technical Advice has been prepared pursuant to Articles 39(4) and 39(5) of Regulation 1060/2009 on credit rating agencies as amended (the CRA Regulation). These articles require ESMA to provide its views on the functioning of the credit rating industry and the impact of specific provisions of the CRA Regulation regarding conflicts of interest, competition and structured finance instruments (SFIs).

2. The Technical Advice draws together ESMA's reflections on how the objectives of the CRA Regulation are being achieved in practice by reference to ESMA's practical experience of supervision and the experiences of the National Competent Authorities and Sectoral Competent Authorities. It also presents data submitted by credit rating agencies (CRAs) to ESMA's Central Repository (the CEREP database) and the responses received to ESMA's Call for Evidence on Competition, Choice and Conflicts of Interest in the CRA Industry which ran from 5 February 2015 until 31 March 2015.

3. ESMA notes that it is difficult to assess the impact of the CRA Regulation on the industry as a whole or the impact of particular provisions in quantitative terms as any changes observed in the industry in recent years could also be explained as effects of the global financial and economic crisis or as the result of changes to prudential regulation. Against this background, ESMA provides an overview of the situation in the markets for credit ratings by considering how individual markets and overall market dynamics have changed between 2009 and 2014.

Market dynamics

4. ESMA finds that there are separate product and geographic markets for credit ratings of different types as credit ratings are highly individualised products developed using different methodologies which are not easily substitutable for each other. The markets for credit ratings at Member State and international level may be seen as platform markets which bring together different customer groups because issuers wish to use those platforms which are recognised by the investors they seek to target and investors wish to use those platforms which provide credit ratings on the issuers and the instruments in which they want to invest.

5. Platform markets are often characterised by the presence of only a few firms, so they may be quite highly concentrated and market entry might not be immediate due to the presence of barriers to entry. The concentrated nature of the industry is reflected by the fact that although there are now 38 CRAs registered in the EU the markets in most Member States are still only served by a few CRAs. In general terms, the barriers to entry faced by firms wishing to operate as CRAs include regulation, the need for local market and industry specific expertise as well as the need to establish a network of issuers and investors on both sides of their platform.

Conflicts of Interest

6. In assessing the effectiveness of the provisions of the CRA Regulation regarding conflicts of interest, ESMA has considered the appropriateness of existing and alternative remuneration models and the impact of Article 6 regarding independence and the avoidance of conflicts of interest by CRAs, Article 7 regarding the qualifications and roles and responsibilities of CRAs' employees, Article 8 regarding

methodologies and the related requirements of Annex I of the CRA Regulation.

7. ESMA finds that as the CRA Regulation does not prescribe the use of any particular remuneration model, CRAs currently use investor-pays models and offer subscription services alongside the issuer-pays model. This flexibility is welcomed by market participants and should be retained.

8. A number of provisions have been introduced to increase the transparency and independence of CRAs. Although some of the required policies and procedures are still bedding in, particularly amongst smaller CRAs and new entrants, ESMA finds that these requirements have improved CRAs governance structures and internal control mechanisms. The broad requirements of Articles 6 and 7 have given ESMA greater insight into the operation and management of CRAs in a number of ways, for example through its work with independent non-executive directors (INEDs).

9. The provisions of the CRA Regulation relating to conflicts of interest have allowed ESMA to be flexible in its approach to supervision and the increased transparency required of CRAs has been welcomed by market participants. However, providing additional clarity as to some of the requirements of Articles 6 and 7, for example regarding internal control mechanisms and risk assessment procedures, could further enhance the effectiveness of ESMA's supervision of CRAs.

Competition

10. In considering the appropriateness of additional measures to foster and promote competition against the background of the evolution of the structure of the sector, ESMA has examined the provisions of the CRA Regulation relating to registration, enforcement and civil liability and measures to increase transparency. ESMA has also considered the implementation of Article 8d regarding the need to consider appointing a CRA with less than a 10% market share and the oversight of fees charged by CRAs.

11. Overall, ESMA finds that the Regulation has given greater visibility to CRAs operating in the EU, for example through registration with ESMA and the public disclosure of information about credit ratings issued. ESMA's enforcement work may also assist in this regard by highlighting the standards expected of CRAs. ESMA's experience to date suggests that the impact of its enforcement powers would be increased if all the requirements of the CRA Regulation were to have a corresponding infringement and if ESMA's ability to impose fines could be tailored to have a more dissuasive effect, by better reflecting the turnover of the CRAs operating in the EU.

12. Whilst it is too soon to conclude on the overall effect of the increased visibility offered by the CRA Regulation on competition between CRAs, it appears that smaller CRAs and new entrants are not yet issuing a significant number of credit ratings in all asset classes. In addition, frequent fee increases and the high fees charged by the largest CRAs operating globally for credit ratings and related research services and data licences suggest that there is little competition between these CRAs. ESMA believes that its supervisory effectiveness will be enhanced in this regard by its on-going work to clarify the definition of ancillary services in the CRA Regulation. ESMA's supervisory effectiveness would be further enhanced by the introduction of an infringement which mirrors Annex I Section B 3c regarding the level of fees charged by CRAs.

13. It is not possible to assess the impact of Article 8d on competition between CRAs at this stage as it has not yet been fully implemented and enforced at national level. ESMA continues to work with the Member States to encourage the development of a common approach to the supervision of Article 8d and is considering whether guidance needs to be provided to SCAs or issuers at Member State or EU level. However, ESMA notes that Article 8d may not be fully achieving its aim of stimulating competition as the market share calculation it requires is very broad. The calculation of CRAs' market shares by revenues or share of supply in the major categories of credit ratings issued at Member State level could be of greater value to issuers and investors in assessing CRAs' experience.

14. Smaller CRAs and new entrants have reported that regulatory and contractual barriers are making it harder for them to develop their business by issuing solicited credit ratings. This means that they can only demonstrate the quality of their credit ratings through the issue of unsolicited credit ratings. ESMA is monitoring the development of several on-going mapping exercises at EU level which may assist CRAs in this regard.

Structured finance instruments

15. ESMA has also considered the evolution of the markets for credit ratings of SFIs and the markets for re-securitisations in its Technical Advice. It has in particular, considered Article 6b of the CRA Regulation regarding the mandatory rotation of CRAs issuing credit ratings on re-securitisations with underlying assets from the same originator, Article 8b regarding the disclosure of information relating to SFIs and Article 8c which requires issuers and related third parties to obtain at least two credit ratings for SFIs.

16. The markets for re-securitisations were not good sample markets in which to test the effect of a mandatory rotation provision for CRAs as these markets have not revived in the EU following the financial crisis. This means that Article 6b has not been used in practice. However, responses to the Call for Evidence showed that market participants were not convinced of the merits of a mandatory rotation provision, either for re-securitisations or more generally. It does not appear that requiring CRAs to provide hand-over files would help to implement a mandatory rotation provision as this could raise concerns about the independence of CRAs. Furthermore, the increased insight that these files could provide into CRAs' rating practices would not help to stimulate competition between CRAs.

17. As only four CRAs have experience of issuing credit ratings for re-securitisations and only six CRAs are issuing ratings for SFIs in the EU overall, there are not enough CRAs rating these products for a rotation provision to work effectively in practice, especially given the obligation in Article 8c of the CRA Regulation to obtain multiple credit ratings for SFIs. It appears that this obligation has had only a limited impact to date as it mirrors existing market practice.

18. It is not possible to determine whether there is a need to extend Article 8b of the CRA Regulation to include other financial credit products as this article has not yet been implemented. However, ESMA highlights that any amendment to existing disclosure requirements should be considered in light of further work at EU level on transparency and due diligence requirements for SFIs and similar products. Any such amendments should be introduced for all comparable market segments or

instruments so as not to make it more costly or onerous to issue some instruments compared to others.

19. Before considering any further initiatives regarding credit ratings for SFIs, ESMA stresses the importance of carrying out detailed impact assessments which take into account the specificities of the markets for credit ratings of individual asset classes.

Conclusion

20. The Technical Advice concludes that the CRA Regulation already appears to have had a positive impact on the governance and operation of CRAs overall. However, it is important to wait and see how the markets develop in response to the implementation of the CRA Regulation before considering the adoption of further measures. This assessment should be revisited by ESMA within the next 3-5 years depending on changes in market dynamics. In light of the concerns raised in the Technical Advice about their effectiveness, ESMA will, in particular, keep the following provisions under review:

    a) Article 6 and Annex I regarding conflicts of interest;
    b) Article 6b regarding mandatory rotation;
    c) Article 8d regarding the requirement to consider using CRAs with less than a 10% market share; and
    d) Annex I Section B 3c regarding fees charged by CRAs for credit ratings and ancillary services.

2 Introduction

21. The European Securities and Markets Authority (ESMA) is one of the three European Supervisory Authorities (ESAs) which, together with the European Systemic Risk Board (ESRB), make up the European System of Financial Supervision (ESFS). The ESFS was established in the wake of the global financial crisis with the aims of improving the quality and consistency of national supervision, strengthening the oversight of cross-border groups and establishing a single rule book for all financial market participants within the European Union (EU).[1]

22. In 2011 ESMA was designated as the single supervisor of credit rating agencies (CRAs) within the EU in accordance with the provisions of Regulation 1060/2009 on credit rating agencies.[2] The CRA Regulation introduced a common approach to the regulation and supervision of CRAs within the EU. This approach was designed to enhance the integrity, transparency, responsibility, good governance and independence of CRAs to ensure high quality credit ratings and high levels of investor protection.[3]

23. The mandate to provide this Technical Advice is set out in Articles 39(4) and 39(5) of the CRA Regulation. These Articles require the European Commission (the Commission) to provide reports to the European Parliament and the Council which assess the impact of the CRA Regulation in a number of key areas as well as the evolution of the CRA industry in general, after obtaining Technical Advice from ESMA.[4]

24. This Technical Advice draws together ESMA's reflections on how the objectives of the Regulation are being achieved in practice by reference to ESMA's practical experience of supervision, the experiences of the National Competent Authorities (NCAs) and Sectoral Competent Authorities (SCAs). It also draws on data submitted by CRAs to ESMA's Central Repository (the CEREP database) and the responses received to ESMA's Call for Evidence on Competition, Choice and Conflicts of Interest in the CRA Industry (the Call for Evidence).[5]

25. The Call for Evidence ran from 5 February 2015 until 31 March 2015 and generated 62 responses. 34 responses came from issuers, 15 from CRAs, 11 from investors, one response from an academic and one from a special interest group. In some cases respondents replied individually and in other cases they responded through their trade association or industry body. ESMA received 26 responses for publication

[1] Regulation EU No 1095/2010 of 24 November 2010 establishing a European Supervisory Authority, OJ L 331/84 of 15.12.2010 at recital 5 (hereinafter the ESMA Regulation), available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009R1060&from=EN, last accessed 26.08.2015.

[2] Regulation EU No 1060/2009 of 16 September 2009 on credit rating agencies, OJ L 302/1 of 17.11.2009 as amended by Regulation 513/2001 of 11 May 2011, OJ L145/30 of 31.5.2011 at recital 5-6, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:145:0030:0056:EN:PDF, last accessed 26.08.2015, and further amended by Regulation 462/2013 of 21 May 2013, OJ L146/1 of 31.5.2013, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0462&from=EN, last accessed 26.08.2015 (hereinafter the CRA Regulation).

[3] See Article 1 of the CRA Regulation.

[4] The full legislative mandate is set out in Annex I of the Technical Advice.

[5] The Call for Evidence is available on ESMA's website at: http://www.esma.europa.eu/system/files/esma2015-233_call_for_evidence_competition_choice_and_conflicts_of_interests_in_the_cra_industry.pdf, last accessed 11.08.2015.

on its website.[6] ESMA also engaged with a number of organisations during the Call for Evidence.[7]

2.1 The CRA Regulation

26. The CRA Regulation aims to promote transparency, financial stability and investor protection and to stimulate competition between CRAs. The Regulation seeks to achieve these objectives by requiring CRAs to be registered before they can issue credit ratings in the EU for use for regulatory purposes. In order to ensure the production of high quality credit ratings, the CRA Regulation introduced measures to mitigate and manage conflicts of interest through the use of policies and procedures and disclosures.

27. The CRA Regulation has been amended twice since its introduction, in 2011 and 2013. The 2011 amendments to the CRA Regulation gave ESMA investigation and enforcement powers to ensure compliance with the Regulation, which can be found in Articles 23-25 and Article 36 of the CRA Regulation.

28. The most recent amendments to the CRA Regulation focused in particular on measures to increase transparency and strengthen competition in certain areas through the introduction of the following Articles:

- Articles 5a, 5b and 5c on reducing reliance on credit ratings.[8]
- Article 6a regarding conflicts of interest arising from investments in CRAs.[9]
- Article 6b regarding mandatory rotation of CRAs rating certain re-securitisations.
- Article 8a regarding sovereign credit ratings.
- Article 8b requiring the disclosure of information about structured finance instruments (SFIs).
- Article 8c requiring multiple credit ratings for SFIs.
- Article 8d regarding the use of smaller CRAs when seeking multiple credit ratings.

2.2 Overview of Technical Advice

29. Following this introductory section, Section 3 of the Technical Advice presents the evolution of the CRA industry in recent years. It describes the nature of the industry and explains the different business models CRAs use, the geographic coverage of CRAs registered with ESMA and the size of the markets for credit ratings by reference to data retrieved from the CEREP database and information collected by ESMA.

30. Against this background, Section 3 of the Technical Advice further considers the industry dynamics and the nature of competition between CRAs. It examines the

[6] The non-confidential responses are available at: https://www.esma.europa.eu/consultation/Call-Evidence-Competition-Choice-and-Conflicts-Interests-CRA-Industry#responses, last accessed 26.08.2015. Please note that references to all responses provided have been anonymised in the Technical Advice to respect the confidential nature of some of the responses received to the Call for Evidence.
[7] A full list of organisations which contributed to the Call for Evidence is provided in Annex II of the Technical Advice.
[8] The question of whether there is a need to propose measures to reduce overreliance on ratings as set out in Article 39(5)(g) of the CRA Regulation is considered in the Technical Advice on Reducing Sole and Mechanistic Reliance on External Credit Ratings prepared in accordance with Article 39(b)1 of the CRA Regulation.
[9] The implementation of Article 6a of the CRA Regulation will not be considered by ESMA in this Technical Advice.

scope of the product and geographic markets for credit ratings and the amount of market power exercised by the CRAs operating in each of these markets. This section then considers the concentrated nature of the CRA industry and highlights some of the risks which may arise from such concentration.

31. ESMA notes that it is difficult to assess the impact of the CRA Regulation on the industry as a whole or the impact of particular provisions in quantitative terms as any changes observed in the industry since 2010 could also be explained as effects of the global financial and economic crisis or results of changes to prudential regulation. With this in mind, Sections 4-6 of the Technical Advice consider the impact of the provisions of the CRA Regulation regarding conflicts of interests and the use of different remuneration models by CRAs, competition between CRAs and provisions relating to SFIs.

32. Section 4 of the Technical Advice examines the use of different business models and considers the impact of the requirements in Articles 6-8 of the Regulation regarding disclosures and measures to be taken by CRAs to mitigate and manage conflicts of interest.

33. Section 5 of the Technical Advice looks at those provisions of the CRA Regulation which may have an impact on competition between CRAs, from registration, enforcement and civil liability to Article 8d of the CRA Regulation and the provisions relating to fees set out in Annex I Section B 3 of the Regulation.

34. Section 6 of the Technical Advice then considers the particular measures to increase investor confidence and stimulate competition in the markets for SFIs set out in Article 6b of the CRA Regulation regarding the mandatory rotation of CRAs, Article 8b regarding information on SFIs and Article 8c regarding multiple ratings for SFIs.

35. Section 7 of the Technical Advice concludes by noting future developments and presenting ESMA’s advice to the Commission by reference to the points raised in Articles 39(4) and 39(5) of the CRA Regulation.

3 The evolution of the CRA sector in the EU 2009-2015

36. This Section of the Technical Advice provides an overview of the CRA industry and considers how the industry has developed between 2009 and 2015. The observations made are based on tables and figures created by ESMA from the information provided by CRAs at registration; periodic reports submitted pursuant to the CRA Regulation and CRAs' reports to the CEREP database. Where CEREP data is presented, this reflects the data available as at 30 September 2015.[10]

3.1 Background

37. Credit ratings are opinions about the credit risk associated with sovereign states or individual corporate entities, such as companies, banks and insurers as well as the financial instruments issued by these entities and states. Rated instruments include bonds and structured finance instruments (SFIs).

38. Credit ratings are qualitative and quantitative assessments of the credit worthiness of entities and financial instruments. The element of qualitative assessment included in the development of credit ratings differentiates them from credit scores.[11]

39. Credit ratings are produced by CRAs. A CRA is a company which sells credit ratings and may also sell related products and services such as ratings databases, data feeds and research reports.

40. CRAs develop methodologies for assessing the credit risk associated with different countries, industries, entities and instruments. These methodologies are then used to produce credit ratings. The assessments made by the analysts, the ratings data they produce and in some cases the related analytical tools and models that they use are distributed to issuers, investors and other market participants either free of charge of for a fee.

41. Credit ratings may be disclosed publically or distributed by subscription. Credit ratings may also be produced pursuant to an individual order. These private credit ratings are not intended for public disclosure.[12]

42. Credit ratings are usually presented by reference to a rating scale. A rating scale may be made up of numbers, letters or symbols or a combination of these, and may differ for different types of rated instruments. A rating scale helps users of credit ratings to understand how the relative credit risk of different rated entities and instruments differs. As the methodologies used by each CRA are different, credit ratings from different CRAs cannot be automatically compared to each other or substituted for each other.[13]

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[10] Subject to a number of minor amendments made by ESMA following validation of the data by the CRAs concerned.

[11] Article 2(2) of the CRA Regulation explains that these scores and systems, as well as credit ratings produced by export credit agencies and credit ratings produced by Central Banks in specific cases, fall outside the scope of the CRA Regulation. See also ESMA/2013/720, ESMA Guidelines and recommendations on the Scope of the CRA Regulation of 17 June 2013 available at: http://www.esma.europa.eu/system/files/2013-720_guidelines_and_rec_on_cra_regulation_scope.pdf, last accessed 11.08. 2015. These guidelines explain that a measure of creditworthiness derived from summarising and expressing data based only on a 16 pre-set statistical system or model, without additional substantial qualitative rating-specific analytical input from a rating analyst, should not be considered as a credit rating.

[12] Pursuant to Article 2(2)(a) of the CRA Regulation the provision of private credit ratings is not regulated in the EU. See ESMA 2013/720 at footnote 11 above.

[13] The heterogeneous nature of credit ratings has been recognised by legislators. See for example, Regulation EU 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit

43. CRAs may operate under a number of different business models. There are business models which focus more on the buy-side or investor side of the market and those which focus on the sell-side or issuer side of the market. In some cases credit ratings are issued on a subscription basis to all interested market participants. Services related to the provision of credit ratings, such as access to ratings databases and reports are also commonly sold by subscription.

44. The sell-side model is most commonly referred to as the issuer-pays model. Under this model credit ratings are issued which are paid for by the entities seeking ratings for their companies or financial instruments. Under the buy-side model, credit ratings are paid for by investors rather than issuers, so this model is commonly referred to as the investor-pays model.

3.1.1 Uses of credit ratings

45. Issuers may use credit ratings for different reasons. Primarily they are used as a way of attracting investment in an entity or a financial instrument from investors with a particular risk profile. Issuers are also required to have a number of credit ratings from particular CRAs if they want their instruments to be used in certain ways, such as for the European Central Bank's (ECB) monetary policy operations, or to meet the criteria for inclusion in a bond index.

46. Investors use credit ratings as a relative measure of the creditworthiness of the entities or instruments in which they are looking to invest. Investors usually have mandates which permit them to invest in instruments and entities up to a maximum level of credit risk. These requirements can be captured in investment mandates. Some investment mandates are quite specific about the level of risk they will tolerate, stipulating not only that the investments should be rated at or below a certain risk level, but also that the ratings need to be assigned by the specific CRAs named in the mandate.

47. Investors and issuers as well as other market participants such as the banks responsible for advising on, arranging or underwriting the issue of financial instruments, may also purchase related services from CRAs including ratings databases, data feeds and research reports. These services help entities to understand market sentiment, to conduct due diligence and enter into transactions, to perform treasury functions such as cash management, liquidity planning and control, or to manage interest, currency and commodity risks.[14]

institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013 (the Capital Requirements Regulation) available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0575&from=EN, last accessed 26.08.2015 and Directive 2009/138 of 25 November 2009 on the taking up and pursuit of the business of Insurance and Reinsurance, OJ L 335, 17.12.2009, as amended by the Omnibus II Directive (Solvency II), available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009L0138&from=EN, last accessed 26.08.2015.

[14] The use of credit ratings in regulation and investment mandates is not considered in detail in this Technical Advice. For a discussion on the use of ratings by different categories of financial intermediary please see JP/DP 2014/01, Joint Committee Discussion Paper on the Use of Credit Ratings by Financial Intermediaries, 23 December 2014, available at: https://www.esma.europa.eu/system/files/jc_dp_2014_01_-_discussion_paper_on_use_of_credit_ratings_by_financial_intermediaries.pdf, last accessed 02.09.2015.

3.1.2 Regulation of credit rating agencies

48. CRAs need to comply with the regulatory requirements in place in the jurisdiction in which they wish to issue ratings. Once registered with ESMA, CRAs are able to issue ratings in the EU for regulatory purposes. This Technical Advice focuses on CRAs registered in the EU. However, the CRA Regulation also provides that ratings issued by CRAs from third countries may be used in the EU where certain conditions are fulfilled.

49. Registered CRAs can endorse ratings issued outside the EU provided that the conditions set out in Article 4 of the CRA Regulation are met. This article provides that CRAs seeking to endorse credit ratings must be able to demonstrate to ESMA on an on-going basis that the conduct of the credit rating activities resulting in the issue of ratings to be endorsed fulfil requirements which are at least as stringent as those regarding conflicts of interest and disclosures and reporting,[15] subject to a number of exceptions.[16]

50. In addition, CRAs established in third countries may issue ratings on entities established or financial instruments issued in third countries in accordance with Article 5(1) of the CRA Regulation where they have been certified as equivalent in accordance with the procedure set out in Article 5 of the CRA Regulation.[17]

51. Since the entry into force of the Capital Requirements Regulation[18] in 2013, all EU registered CRAs have had the status of External Credit Assessment Institutions (ECAIs) which means that their credit ratings can be used for the purposes of applying risk weightings in the assessment of capital requirements. Technical Standards are currently being developed at EU level to implement this change.[19]

52. ESMA publishes a complete list of EU registered and certified CRAs on its website in accordance with Article 18(3) of the CRA Regulation.[20] In addition, Article 135(2) of the Capital Requirements Regulation requires the European Banking Authority (the EBA) to publish lists of ECAIs registered or certified in accordance with the CRA Regulation and Article 2(4) of the CRA Regulation requires the Commission to publish a list of central banks issuing credit ratings which are exempt from the application of the CRA Regulation.[21]

53. EU registered CRAs are not automatically granted ECAI status under the ECB's Eurosystem Credit Assessment Framework (ECAF) which determines the minimum requirements for assets to be accepted by the Eurosystem as eligible collateral for

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[15] As set out in Articles 6-12 of the CRA Regulation.
[16] Endorsed ratings do not need to comply with a number of the requirements of the provisions of Article 6a, 6b, 8a, 8b, 8c, 11a and Annex I Section B point 3 (ba), point 3a and 3b of the CRA Regulation.
[17] Article 5(4) notes that certified CRAs can apply for exemptions from some or all of the requirements of Section A of Annex I of the CRA Regulation relating to the organisational requirements for CRAs such as the requirements regarding the board, the roles of senior management, the establishment of policies and procedures, internal control mechanisms, a dedicated compliance function, or regarding analyst rotation where they can demonstrate that the requirements are not proportionate in view of the nature, scale and complexity of its business and the nature and range of its issuing of credit ratings.
[18] Regulation EU 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013, referred to in footnote 13 above.
[19] As explained in Section 5 below.
[20] http://www.esma.europa.eu/page/List-registered-and-certified-CRAs, last accessed 26.08.2015.
[21] Regulation 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176/1 of 27.6.2013 referred to in footnote 13 above.

monetary policy operations.[22] Only four of the EU's registered CRAs are recognised as ECAIs under the ECAF.

3.2 Industry data

54. This subsection presents data about the CRA industry in the EU through tables and figures produced using information collected by ESMA. The majority of the information presented comes from the information publically available through ESMA's Central Repository (the CEREP database) which was established pursuant to Article 11(2) of the CRA Regulation. CRAs report data about the credit ratings that they issue to the CEREP database in accordance with Commission Delegated Regulation 446/2012 of 21 March 2012 with regard to regulatory technical standards on the content and format of ratings data periodic reporting.[23]

55. The CEREP database collects data on credit ratings issued by CRAs that are registered in accordance with the CRA Regulation, on credit ratings that are endorsed by registered CRAs and on credit ratings issued by certified CRAs.

56. In addition, CEREP collects data about credit ratings issued in a third country by CRAs not certified or registered in the Community but belonging to the same group as registered CRAs where they provide these to CEREP on a voluntary basis.

57. Some of the information reported to the CEREP database is available to the public through the ESMA website. The CEREP pages of the ESMA website allow market participants to search, filter, print and download statistics regarding credit rating activity, default rates and rating transition for each CRA for different time periods.[24] The categories of ratings covered by the CEREP database are corporate, sovereign and sub-sovereign, structured finance and covered bonds. In the corporate and sovereign and sub-sovereign categories, data is reported about credit ratings at issuer level whereas for the corporate and covered bond categories data is reported at issue level.

58. For the purposes of this Technical Advice, ESMA will present only the CEREP data submitted by CRAs registered in Europe which is publically accessible through the ESMA website. For groups of CRAs, ratings endorsed by their EU based entities will also be taken into account. Only data regarding long term credit ratings will be presented to avoid duplication.

59. Each CRA submits individual reports to the CEREP database and each CRA is responsible for the accuracy and completeness of the data they provide. CRAs are permitted to change the data submitted in previous periods to correct factual errors. ESMA monitors the submission of data to CEREP and all of the changes that CRAs make to data previously submitted. The CEREP data presented in this Technical Advice represents the data available as at 30 September 2015 which has been validated by CRAs and by ESMA.[25]

[22] Further information about the Eurosystem is available on the ECB's website, https://www.ecb.europa.eu/pub/pdf/other/legalframeworkeurosystemescb2014en.pdf, last accessed 11.08.2015.
[23] OJ L140/2 of 30.5.2012, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0446&from=EN, last accessed 27.08.2015.
[24] The CEREP search screen is available on the ESMA website at: http://cerep.esma.europa.eu/cerep-web/statistics/ratingActivity.xhtml, last accessed 28.07.2015.
[25] The next update of the CEREP database will be made publically available in October 2015.

60. The CEREP data presented is supplemented by publically available information and information received through ESMA's Call for Evidence.

3.2.1 Credit rating agencies operating in the EU

61. In 2009, prior to the entry into force of the CRA Regulation, 24 CRAs were established in the EU according to the Commission's 2010 Impact Assessment.[26] In 2009, data was reported to ESMA's predecessor, the Committee of European Supervisors (CESR) by 17 CRAs in total. Reports were received from Standard & Poor's Rating Services (S&P); Moody's Investors Service (Moody's) and Fitch Ratings (Fitch) and from 14 CRAs not affiliated with these three CRAs. Of these, one was based in Bulgaria; one in Cyprus; one in Greece; six in Germany; one in Italy; one in Portugal; one in Slovakia; and two in the UK.

62. ESMA records the registration of CRAs by their primary place of establishment within the EU. Table 1 in Annex IV provides a list of CRAs registered and certified to issue credit ratings in the EU. The table shows that 31 CRAs were registered by the national competent authorities or were in the process of being registered at national level between the entry into force of the CRA Regulation on 6 December 2009[27] and 1 June 2011, when ESMA assumed responsibility for the registration of CRAs.[28]

63. Of these CRAs, 16 were EU subsidiaries of the three largest CRAs operating globally. Of the remaining 15, one was registered in Bulgaria, one was registered in Cyprus, six were registered in Germany, one was registered in Greece, two were registered in Italy, one in Portugal, one in Slovakia and two in the UK.

64. Since 2012 ESMA has registered a further eight CRAs, bringing the total number of registered CRAs to 38. ESMA registered one CRA in Spain in 2012. In 2013 ESMA registered three CRAs; in the UK, Italy and France. In 2014 two CRAs were registered; one in the UK and one in Poland. At the date of publication of the Technical Advice, ESMA had registered one further CRA in Italy.[29]

65. Of these 38 CRAs, 17 are part of the groups of the three largest CRAs operating globally. Table 1 in Annex IV shows that Moody's has now registered CRAs in six Member States: Germany, France, Cyprus, Spain, Italy and two in the UK (one holding company and one branch). S&P has registered CRAs in France, Italy and the UK and Fitch has registered CRAs in Germany, France, Italy, Poland, Spain and two in the UK (one holding company and one branch).

66. The table shows that there has been an overall increase in the number of registered CRAs not affiliated with the groups of the three largest CRAs operating globally from 15 to 21 between 2011 and 2015. Of these new entrants two are based in Italy, one in the UK and one CRA has been registered in each of Spain, France and Poland.

[26] Commission Staff Working Document Impact Assessment accompanying the proposal for a Regulation amended 1060/2009 on credit rating agencies, SEC (2010) 678 of 2.6.2010 at page 38, available at: http://ec.europa.eu/finance/securities/docs/agencies/100602-impact-assesment_en.pdf, last accessed 26.08.2015.
[27] Article 41 of Regulation 1060/2009 of 16 September 2009 on credit rating agencies, OJ L 302/1 of 17.11.2009, referred to in footnote 2 above.
[28] Recital 6, Article 2 and Article 15 of Regulation 513/2011 amending Regulation 1060/2009 on credit rating agencies, OJ L 145/30 of 31.5.2011 referred to in footnote 2 above.
[29] ESMA 2015/1174 Public Statement of 10 July 2015, available at: http://www.esma.europa.eu/system/files/2015-1174_public_statement_on_modefinance_registration.pdf, last accessed 19.08.2015. Data from this CRA is not included in the CEREP data presented as this covers the period 2009 to 2014.

67. The EU registered CRAs which are issuing endorsed ratings are the three largest CRAs operating in the EU and DBRS. Four third-country CRAs have been certified to issue credit ratings which can be used in the EU. The first CRA to obtain certified status for its ratings was Japan Credit Rating Agency in 2011. Kroll Bond Rating Agency was certified in 2013. Two further CRAs obtained certified status for their ratings in 2014, HR Ratings de Mexico, S.A. de C.V and Egan-Jones Ratings Company.[30]

3.2.2 Ownership of credit rating agencies

68. The groups of the three largest CRAs operating globally made a number of acquisitions in the early part of the new millennium to strengthen their offerings in different local markets. The Commission's 2011 Impact Assessment includes a table which highlights some of the major acquisitions made by these groups.[31] These show that Fitch acquired a number of different credit ratings and related data businesses in order to help it compete against S&P and Moody's, including AMR, a French credit rating agency in 2000 and the Central European Ratings Agency in Poland in 2001. In 2006, Moody's acquired CRA Rating, a CRA based in the Czech Republic.

69. In the EU, CRAs are required to provide information about their ownership structure and their subsidiaries as part of the registration process in accordance with Annex II of the CRA Regulation.[32] CRAs are also required by Article 12 of the CRA Regulation to publish a transparency report each year which provides detailed information on the legal structure and ownership of the CRA, including information on holdings within the meaning of the Transparency Directive.[33]

70. This information shows that there are different types of investors in CRAs. Often those who have established the CRA or who hold senior management positions will have a stake in the CRA themselves. These stakes may be held by the founders and managers either directly or indirectly through family holdings. This applies to more than half of the CRAs registered in the EU and is not limited to CRAs of any particular size or specialisation as it includes S&P, Fitch, DBRS Ratings Limited (DBRS), AM Best Europe-Rating Services Ltd (AM Best), Spread Research SAS (Spread Research) and EuroRating Sp z.o.o (EuroRating).

71. Overall, the types of investors holding shares in CRAs have not changed significantly over time. Two CRAs have changed their shareholder composition so that they are now wholly or partially owned by CRAs from third countries. In addition, four CRAs have experienced a full change of control between 2012 and 2015. Each of these changes is considered below.

72. On registration in 2011 the major shareholder of Companhia Portuguesa de Rating S.A was a consultancy firm. In 2013, the CRA was renamed ARC Ratings S.A.

[30] Endorsed and certified credit ratings will not be considered further in this Technical Advice.
[31] Impact Assessment accompanying the proposal for a Regulation amending Regulation No 1060/2009 on credit rating agencies, SEC (2011) 1354 at page 107, available at: http://ec.europa.eu/internal_market/securities/docs/agencies/SEC_2011_1354_en.pdf, last accessed 26.08.2015.
[32] See Annex II Points 5 and 9 in the CRA Regulation referred to in footnote 2 above. See also Articles 8 and 9 of Commission Delegated Regulation 449/2012 of 21 March 2012 with regard to regulatory technical standards on information for registration and certification of credit rating agencies, OJ L 140/32 of 30.5.2012 available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0449&from=EN, last accessed 26.08.2015.
[33] Directive 2013/50 of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, OJ L 294, 6.11.2013 available at: http://old.eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:294:0013:0027:EN:PDF, last accessed 26.08.2015.

(ARC) and was purchased by a Singapore holding company. This holding company is in turn jointly owned by the original consultancy firm and a number of leading credit rating agencies established outside the EU. The CRAs involved in the venture are Credit Analysis and Research Limited from India; Global Credit Rating Company Limited of Africa; Malaysian Rating Corporation Berhad and the SR Rating Group from Brazil. In addition, Dagong Europe Credit Rating Srl (Dagong), which on registration in 2013 was partially owned by a private equity fund, has been wholly owned by Dagong Global Credit Rating Co since March 2015.

73. In March 2015 DBRS was purchased by private investment funds Carlyle Investment Management LLC and Warburg Pincus LLC in partnership with a consortium of Canadian based individual investors including DBRS' founder, Walter Schroeder and DBRS management.[34] In March 2015 the existing shareholders of the Fitch Group changed their shareholdings so that the Hearst Corporation now owns 80% of the shares and Fimalac S.A. holds the remaining 20%.[35]

74. In 2013 Cerved Group S.p.A was acquired by CVC Capital Partners. In June 2014, 43% of the shares in the holding company Cerved Information Solutions S.p.A were listed on the Italian stock exchange.[36] During 2015 CVC Capital Partners further reduced its interest in Cerved Information Solutions S.p.A (CERVED) to 39.31%, so additional shares were publicly listed on the Italian Stock Exchange.[37]

75. In January 2012, PSR Rating GmbH, referred to in the Commission's Impact Assessment as Professor Dr Schneck Rating, became Scope Holding GmbH (Scope) upon the transfer of 100% of the shares in the company.[38]

76. Other frequent investors in CRAs include financial services companies, such as insurance companies and pension funds, banks, investment management firms and private equity investors.

3.2.3 Credit rating agencies' business models

77. The issuer-pays model is currently the most common way of providing credit ratings in the EU as it is used by the majority of registered CRAs. From the information available to ESMA, it does not appear that CRAs have made dramatic changes to their business models during the period 2009-2014. Table 2 in Annex IV shows that 13 CRAs currently offer investor-pays ratings or ratings paid for by subscribers. It appears that all but three of the CRAs who are issuing ratings by subscription or under the investor-pays model also issue credit ratings under the issuer-pays model.

78. This might suggest that within the EU, business models which focus exclusively on investor-pays ratings or the distribution of ratings by subscription are currently not financially viable on a standalone basis. ESMA is not able to provide a detailed assessment of the contribution that each of these different models make to CRAs' revenues from credit ratings in order to assess their viability at present. However, ESMA should be in a position to provide a more detailed overview in future as it will

[34] The detailed terms of the transaction have not been publically disclosed. See the press release available at: http://www.dbrs.com/research/277553/the-carlyle-group-and-warburg-pincus-complete-acquisition-of-dbrs.pdf, last accessed 11.08.2015.
[35] http://www.fimalac.com/strategic-focus.html, last accessed 26.08.2015.
[36] http://company.cerved.com/en/about-us, last accessed 26.08.2015.
[37] http://company.cerved.com/it/struttura-del-gruppo, last accessed 26.08.2015.
[38] The company's name was then changed to Scope Credit Rating GmbH. See the 2012 transparency report at page 2: https://www.scoperatings.com/download/Transparency_Report_2012.pdf, last accessed 26.08.2015.

start to collect data from CRAs which distinguishes between fees charged for credit rating services provided under these different business models.[39]

3.2.4 Asset classes rated by credit rating agencies

79. Table 1 below shows the different asset classes rated by each registered CRA in 2009 compared to 2014. The table has been compiled using the categories of asset class reported to the CEREP database. These are corporate ratings, which are divided into financial entities, insurance entities and non-financial entities; sovereign ratings, which are divided into sub-sovereign entities, public entities and supranational entities; structured finance ratings and ratings of covered bonds.[40]

80. Table 1 shows that in 2009, of all the EU registered CRAs, only Moody's and S&P were registered to rate all of the categories of asset class reported to CEREP.

<u>Table 1 – Categories of asset class rated by CRAs in 2009 and 2014</u>

CRA	2009									2014								
AM Best		IN	CO								IN	CO						
ARC			CO									CO	**SV**					
ASSEKURATA		IN									IN							
Axesor												**CO**						
BCRA	FI	IN			SS					FI	IN		**SV**	SS				
Capital Intelligence	FI		CO	SV						FI		CO	SV					
CERVED			CO									CO						
Creditreform			CO									CO					**SF**	**CB**
CRIF												**CO**						
Dagong										**FI**	**IN**							
DBRS	FI	IN	CO	SV	SS	PE		SF	CB	FI	IN	CO	SV	SS	PE	**SN**	SF	CB
EIU													**SV**					
Euler Hermes	FI		CO							FI		CO						
European Rating Agency			CO		SS							CO		SS				
EuroRating										**FI**		**CO**						
Feri				SV						**FI**		**CO**	SV					
Fitch	FI	IN	CO	SV	SS		SN	SF	CB	FI	IN	CO	SV	SS		SN	SF	CB
GBB	FI									FI								
ICAP			CO									CO						
Moody's	FI	IN	CO	SV	SS	PE	SN	SF	CB	FI	IN	CO	SV	SS	PE	SN	SF	CB
S&P	FI	IN	CO	SV	SS	PE	SN	SF	CB	FI	IN	CO	SV	SS	PE	SN	SF	CB
Scope			CO							**FI**		CO					**SF**	
Spread Research												**CO**						

Legend:

- **FI** Corporate - Financial
- **IN** Corporate - Insurance
- **CO** Corporate - Non Financial
- **SV** Sovereign
- **SS** Sub-sovereign
- **PE** Public entities
- **SN** Supranational
- **SF** Structured Finance
- **CB** Covered Bonds
- (grey) Non registered / no ratings
- **XX** New asset class

Source: CEREP, ESMA

81. According to the information submitted to the CEREP database, Fitch has rated all of these categories since registration, with the exception of public entities. DBRS has rated all of these categories of asset class since 2012, but did not rate supranational entities before this time.

82. The table shows that the number of registered CRAs offering ratings in each category has increased, with the exception of the public entity category, which has been rated by just three CRAs since 2009: DBRS, Moody's and S&P.

[39] Pursuant to Commission Delegated Regulation 2015/1 of 30 September 2014 with regard to regulatory technical standards for the periodic reporting of fees charged by credit rating agencies, OJ L2/1 of 6.1.2015 available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0001&from=EN, last accessed 26.08.2015.
[40] Annex III Table 3 presents the position for each year between 2009 and 2014.

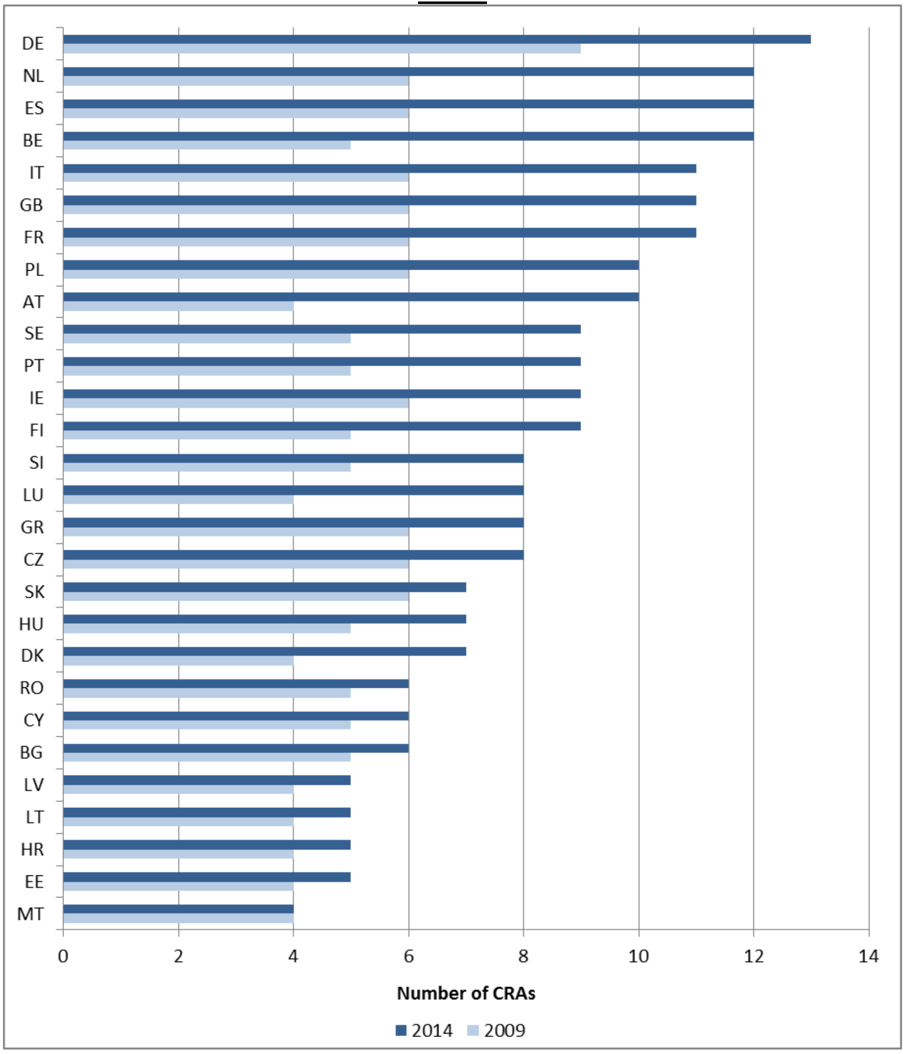
83. The number of CRAs offering corporate financial ratings has increased from eight CRAs to twelve CRAs between 2009 and 2014, with Dagong, EuroRating, Feri EuroRating Services AG (Feri) and Scope adding this category to their rating services after registration.

84. This is mirrored in the corporate non-financial category where the number of CRAs offering ratings increased from 13 to 17 CRAs over the same period through the offer of ratings by CRIF S.p.A (CRIF), Axesor SA (Axesor), Eurorating, and Spread Research.

85. Three more CRAs offered sovereign ratings with the registration of The Economist Intelligence Unit (EIU), and additional offers from ARC, BCRA-Credit Rating Agency Ltd (BCRA). Dagong expanded to offer ratings in the corporate insurance category in 2013. Creditreform Rating AG (Creditreform) started offering covered bond ratings in 2011 increasing the number of CRAs rating these within the EU from four to five.

86. Figure 1 below shows the number of CRAs rating at least one entity or instrument per country. This demonstrates an increase in the number of CRAs operating in every Member State between 2009 and 2014, with the exception of Malta which has been served by four CRAs since 2009.

Figure 1: Number of CRAs rating at least one entity or instrument by EU Member State



Source: CEREP, ESMA

87. In order to give a meaningful view of the impact of the increase in the number of CRAs operating in different parts of the EU, this data should be considered alongside data regarding the number of ratings being issued by these CRAs.

88. Table 4 of Annex IV shows that Creditreform (Germany) actually rated only 27 of the 13,734 covered bonds with outstanding ratings in 2014, less than 1% of the total. For corporate insurance Assekurata Assekuranz Rating-Agentur GmbH (Assekurata) (Germany) provided only 7 of the outstanding ratings in 2014 and Dagong (Italy) only 1 of the total 514 ratings outstanding. For sovereign & sub-sovereign ratings EIU (UK) rated 26, Capital Intelligence (Cyprus) Ltd (Capital Intelligence) (Cyprus) rated 3 and BCRA (Bulgaria) rated 3 of the total 896 ratings outstanding in 2014.

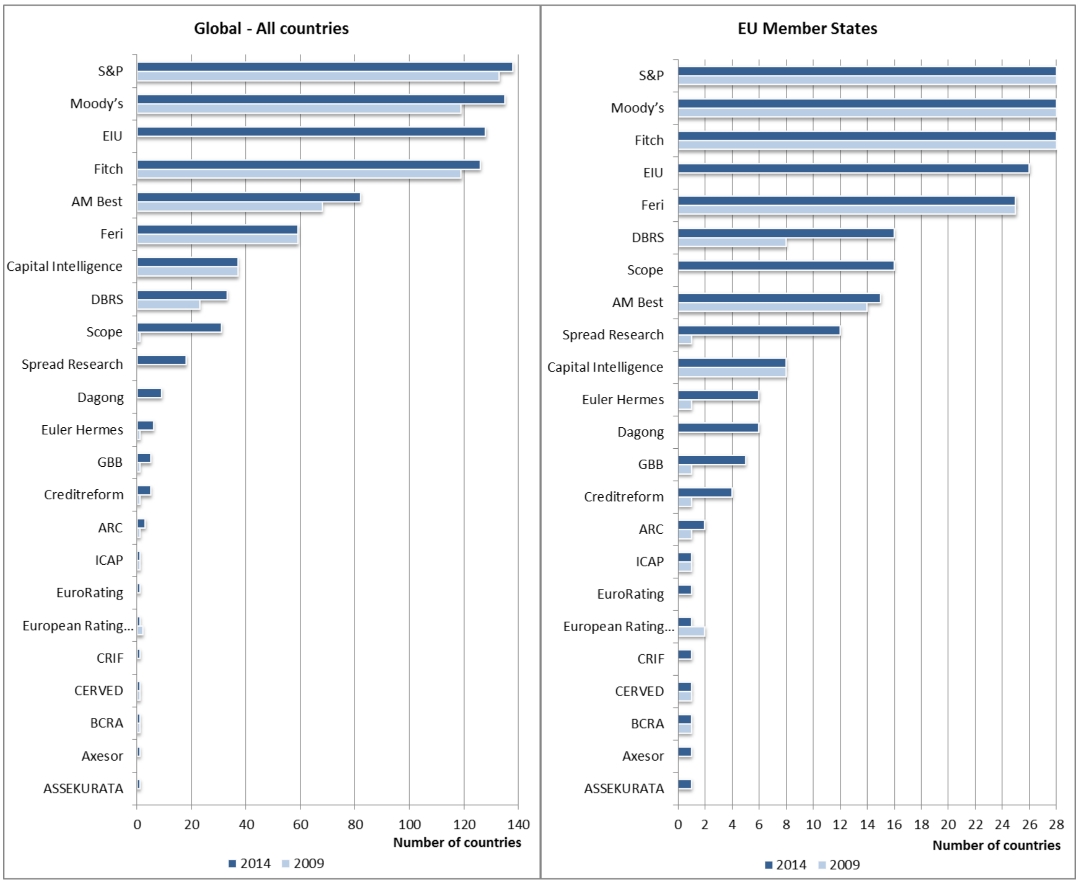
89. In the corporate non-financial segment, Axesor (Spain) provided 61, Feri (Germany) 4 and Eurorating (Poland) 13 of the total of 32,855 credit ratings outstanding in 2014. Of the 1,272 corporate financial ratings outstanding in 2014, Feri (Germany) rated 4 and Scope (Germany) rated 21.

90. These figures suggest that although the number of CRAs operating within the EU Member States has increased, some of these CRAs are currently only issuing a small number of ratings overall.

3.2.5 Geographic coverage

91. Figure 2 below shows how the coverage of each CRA has evolved between 2009 and 2014 in terms of the location of the issuer or instrument rated. More specifically, Figure 2 highlights that the global coverage of the three largest CRAs operating in the EU has not changed. S&P, Moody's and Fitch are issuing ratings for entities/instruments located in more than 120 countries. This figure also shows that EIU and Feri are able to demonstrate broad coverage, but this may be explained by their focus on sovereign ratings.

Figure 2: Countries in or in respect of which EU registered CRAs issue credit ratings



Source: CEREP, ESMA

92. 13 CRAs increased the number of EU Member States in which they were issuing ratings. In addition to the 8 CRAs registered during this period, DBRS increased the number of Member States in which it issued credit ratings from 8 to 16; AM Best from 14 to 15; Euler Hermes Rating GmbH (Euler Hermes) from 1 to 6; GBB-Rating Gesellschaft für Bonitätsbeurteilung GmbH (GBB) from 1 to 5; Creditreform from 1 to 4 and ARC from 1 to 2.

93. The number of CRAs issuing credit ratings in only one Member State was 8 in 2009. Of these 8, 4 CRAs had increased the number of Member States in which they were

issuing ratings by 2014. The figures should be however weighted with the number of ratings issued per country: for example, CERVED only issues ratings in Italy, where it has a very high coverage in the corporate non-financial category because of the ratings that it issues on small and medium-sized companies (SMEs) operating in Italy.

94. A decrease in the number of Member States where ratings were issued is shown in only one CRA, European Rating Agency, where the pre-registration presence is shown to be larger than their presence following registration.

3.2.6 Changes in the markets for credit ratings

3.2.6.1 Overall size

95. The number of solicited and unsolicited ratings issued by asset class for each registered CRA provides the best approximation of the overall size of the markets for rated entities and instruments for each asset class in the EU. The full tables presenting the CEREP data for the period 2009 to 2014 are provided in Tables 4 and 5 of Annex IV. However, the total number of long-term outstanding ratings for EU entities and instruments for each category of credit ratings is compared in the summary table set out below.

Table 2: Total number of outstanding credit ratings by category

Rating Category	2009	2014
Corporate financial	1,504	1,272
Corporate insurance	633	514
Corporate non-financial	104,642	32,855
Sovereign	840	896
SFI	17,024	12,657
Covered bonds	15,388	13,734
Total outstanding	**140,031**	**61,928**

Source: CEREP, ESMA

96. Although this shows the number of outstanding ratings in the EU, ESMA notes that whilst the data reported for SFI and covered bonds is at issuance level, for the other categories credit ratings are reported at issuer level. This means that the CEREP data does not include ratings on corporate issuances and that only one rating per entity is reported for corporate financial, non-financial and insurance entities as well as for sovereigns. This reporting practice means that the impact of credit ratings issued in respect of large corporations is likely to be understated as the total number of outstanding ratings for each corporation is not reported.

97. The decrease in the number of corporate non-financial ratings issued is driven by the fall in outstanding ratings from CERVED, as this CRA reduced the number of ratings of Italian SMEs reported by two thirds during this period.[41]

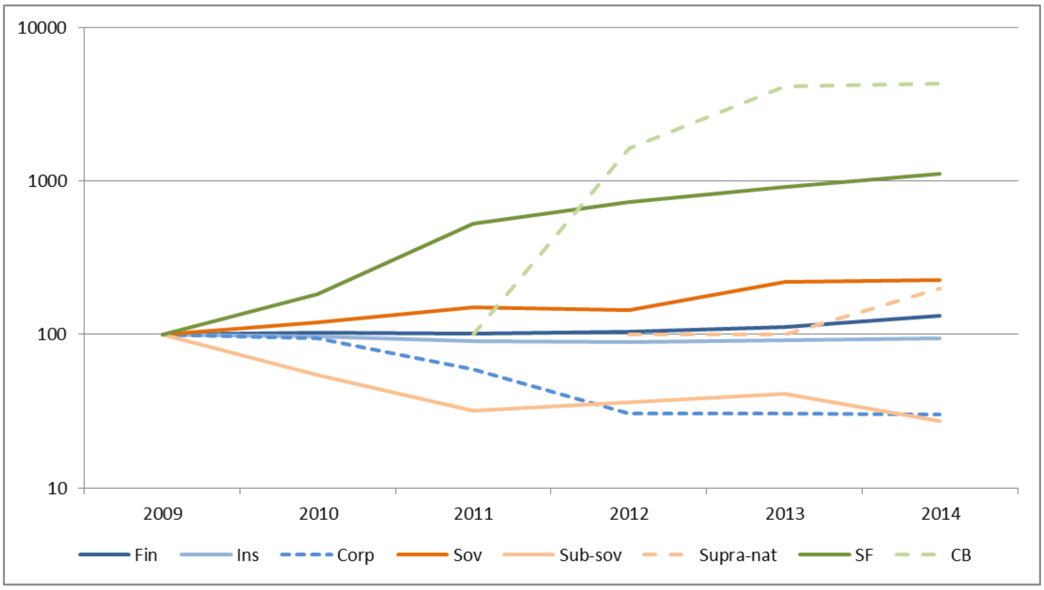
[41] The data reported to the CEREP database by CRAs does not allow the calculation of the size of the overall markets for credit ratings of different asset classes by the value of the issuances rated.

3.2.6.2 Overall evolution of outstanding credit ratings

98. Overall, the data presented in Tables 4 and 5 of Annex IV shows that the number of outstanding ratings in recent years has remained relatively stable, apart from the corporate non-financial and structured finance asset classes. The decrease in the number of corporate non-financial credit ratings is driven by the fall in outstanding credit ratings from CERVED, as noted in paragraph 97 above. Concerning credit ratings for SFIs, the decrease in the number of ratings is largely in line with general market trends.[42] Specific trends can be identified when looking at the evolution of outstanding credit ratings per category and groups of CRAs. ESMA has illustrated this in the following figures for ease of reference.

99. Figure 3 below shows the evolution of outstanding credit ratings from all but the three largest CRAs operating globally.

Figure 3: Evolution of outstanding ratings – All CRAs excluding S&P, Moody's and Fitch (2009=100)*



Source: CEREP, ESMA

** The chart displays the annual percentage variation compared to the base year (2009) on a logarithmic scale*

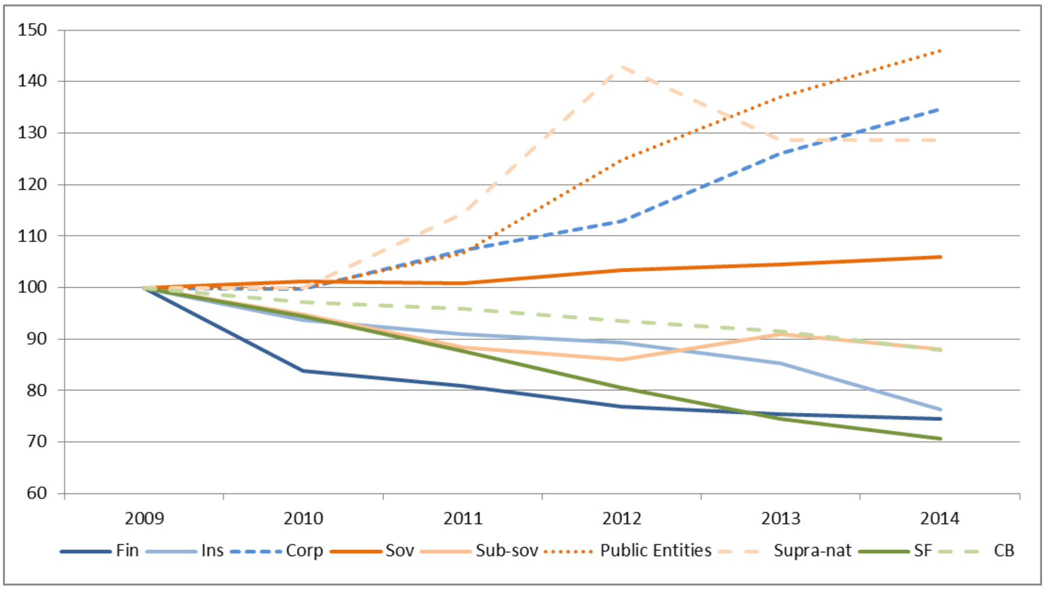
100. Figure 3 shows that the outstanding structured finance and covered bond credit ratings from these CRAs increased by 1000% between 2009 and 2014, which suggests that issuers and investors began to look for alternative CRAs to rate their SFIs as the EU started to emerge from the 2008 financial crisis.

101. The chart also seems to suggest that the number of corporate non-financial ratings from CRAs other than the three largest operating globally decreased considerably between 2010 and 2012. However, the figures for this specific asset class, mainly reflects the decrease in ratings issued by CERVED as explained above.

[42] These are explained in more detail in Section 3.2.6.4 below.

102. Figure 4 below shows the evolution of the credit ratings of the three largest CRAs operating globally. The increase in outstanding structured finance ratings from other CRAs is also reflected here. On the corporate side, the number of credit ratings of financial and insurance entities decreased, whilst the number of outstanding credit ratings on corporate non-financial entities increased substantially.

Figure 4: Evolution of outstanding ratings – S&P, Moody's and Fitch (2009=100)*



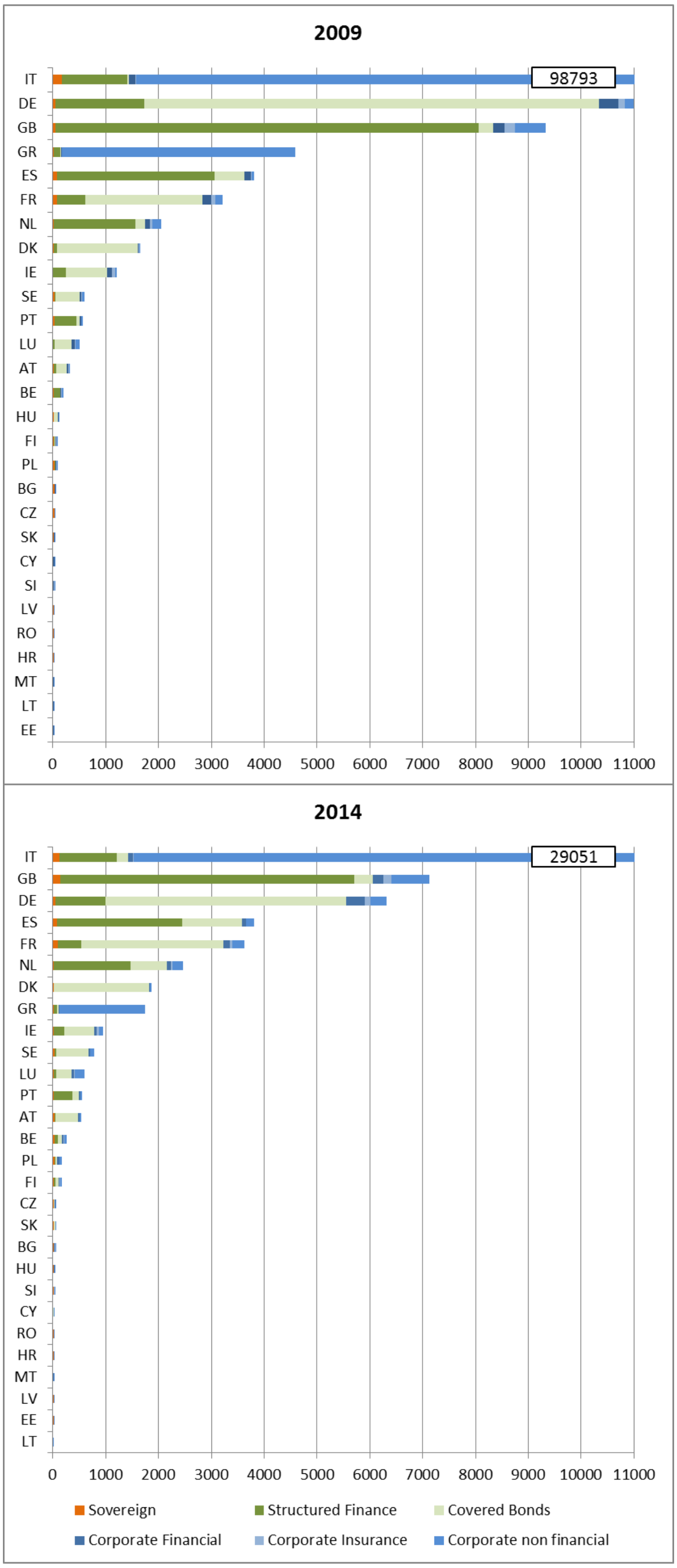
Source: CEREP, ESMA

** The chart displays the annual percentage variation compared to the base year (2009)*

3.2.6.3 Evolution of outstanding credit ratings by Member State and by asset class

103. Annex IV Table 5 and Figure 5 below show how the number of outstanding credit ratings in each EU Member State has changed between 2009 and 2014 for each asset class recorded in CEREP. As a result of the fact that CEREP presents corporate credit rating data at issuer level, the proportion of outstanding credit ratings appears much higher in countries where CRAs' customer bases include a large number of smaller corporations. This means that the high number of outstanding corporate ratings for Greece and Italy can to a large extent be explained by the presence of CERVED and ICAP Group SA (ICAP) which rate a large number of SME corporate issuers in Italy and Greece respectively.

Figure 5: Number of credit ratings by category and by EU Member State (2009-2014)*



Source: CEREP, ESMA

** The total number of corporate non-financial credit ratings for Italy is displayed in the white box*

104. The figures above show that some Member States are centres for particular categories of asset class. For example, the Member States where the most rated SFIs are being issued are the UK, followed by Spain and the Netherlands. At the same time, credit ratings on covered bonds are more frequently issued in Member States such as Germany, France and the Netherlands.

105. It is interesting to note how the size of some national markets has changed relative to others as the EU has emerged from the 2008 financial crisis. Overall the total number of credit ratings issued increased between 2009 and 2014 in 18 Member States and decreased in 10 Member States.

106. The biggest decreases in the number of issued credit ratings were experienced in Italy,[43] Greece, Germany and the UK. This decrease appears to have been driven by decreases in the number of outstanding credit ratings for corporate entities and SFIs in Greece, rated SFIs and covered bonds in Germany and decreases in the number of SFI ratings in the case of the UK.

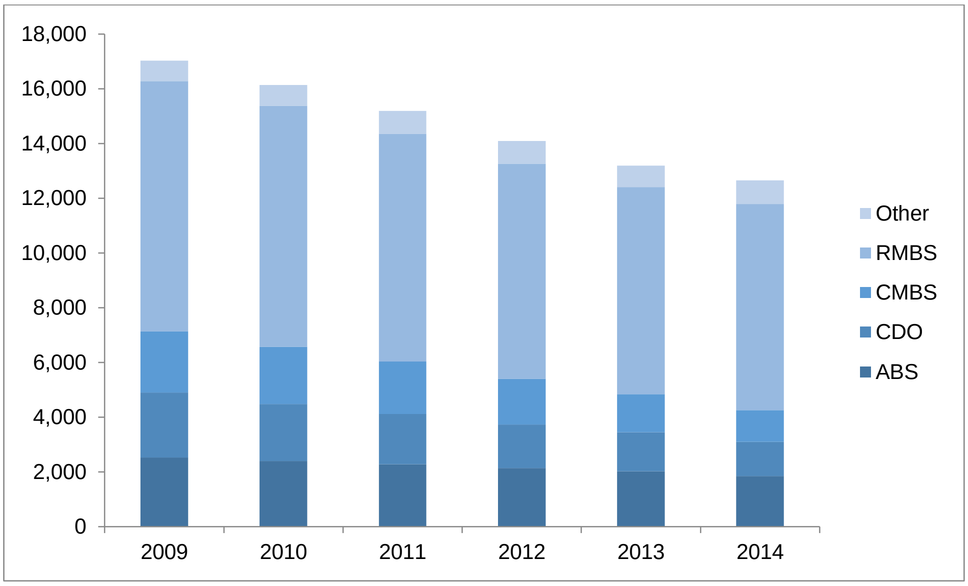
3.2.6.4 Focus on the markets for structured finance instruments

107. The following subsection presents the key developments in the markets for credit ratings of SFIs in the EU. Some of the main asset types which make up the structured finance category are Residential Mortgage Backed Securities (RMBS) and Commercial Mortgage Backed Securities (CMBS). This category also includes Asset Backed Securities (ABS), which use loans, leases and other receivables to back the financial security and Collateralised Debt Obligations (CDO), which are a type of structured ABS backed by a pool of assets.

108. Figures 6 and 7 below show that the number of SFI ratings has declined year-on-year since 2009 by an average of 6%. This development reflects a decrease in the issuance of SFIs over the same period.

[43] The size of the Italian market for corporate ratings appears significant as a large number of smaller corporations are being rated and the decrease is largely driven by the change in reporting by CERVED noted in paragraph 97 above.

Figure 6: Outstanding EU ratings of structured finance instruments by asset class



Source: CEREP, ESMA

109. For all of the listed asset classes a consistent decline can be observed throughout the sample period. The largest asset class, Residential Mortgage Backed Securities (RMBS), experienced the biggest decrease between 2009 and 2012 but appears to have stabilised.

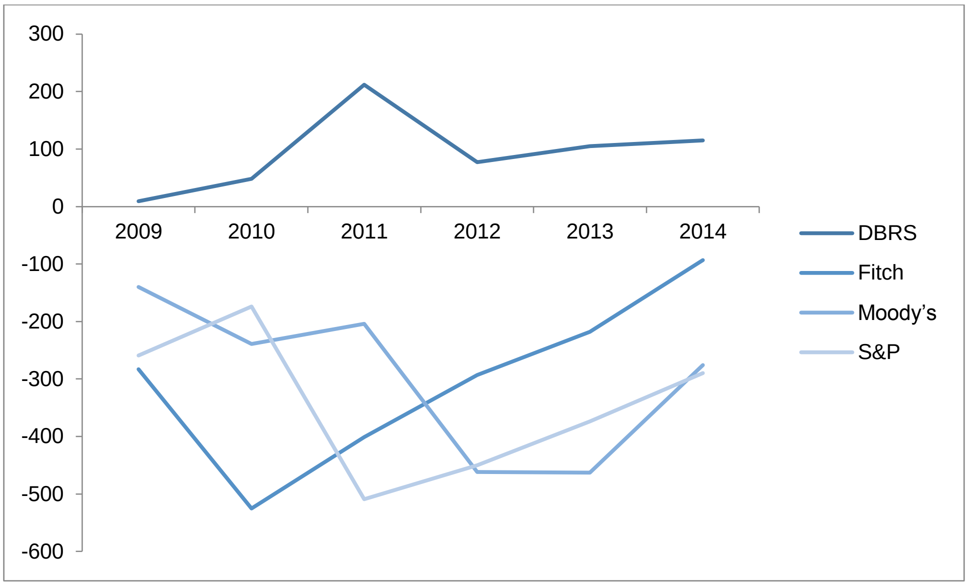
Figure 7: Year-on-year net change in number of outstanding ratings of EU structured finance instruments by asset class

Source: CEREP, ESMA

110. The four largest CRAs issue the vast majority of ratings of SFIs in the EU. Two smaller CRAs based in Germany; Creditreform and Scope, have recently entered the EU SFI markets and hold a marginal share of total supply in these markets. Figure 8 below shows the year-on-year change in the number of outstanding ratings for the four largest CRAs active in the markets for SFIs. The number of credit ratings issued

by Scope and Creditreform is comparatively small. The rating activity of Scope and Creditreform can therefore not be detected in the figure below.

Figure 8: Year-on-year net change in number of outstanding ratings of EU structured finance instruments by CRA

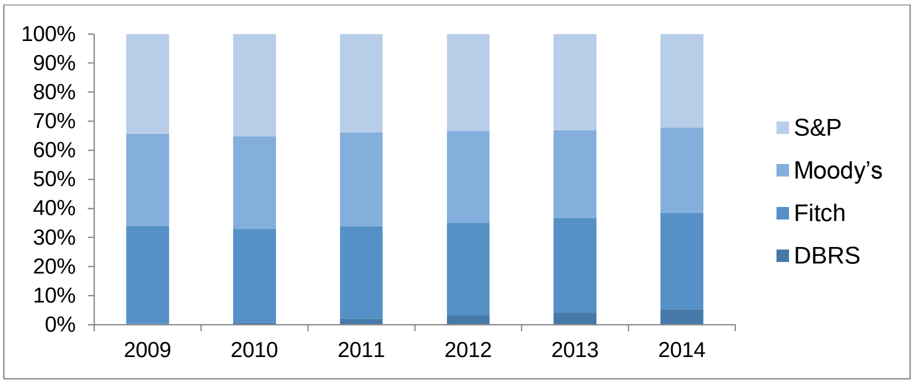


Source: CEREP, ESMA

111. The figure shows that DBRS was the only CRA which consistently increased its number of SFI credit ratings year-on-year between 2009 and 2014. The growth in the number of credit ratings issued by DBRS is also reflected in its overall share of rated EU SFIs.

112. Figure 9 below shows that as a proportion of all outstanding ratings on European SFIs, the number of SFI ratings assigned by DBRS have increased from 0.4% in 2009 to 5.2% in 2014.

Figure 9: Outstanding ratings of EU structured finance instruments by CRA



Source: CEREP, ESMA

3.2.6.5 Credit rating agencies' overall revenues from credit ratings

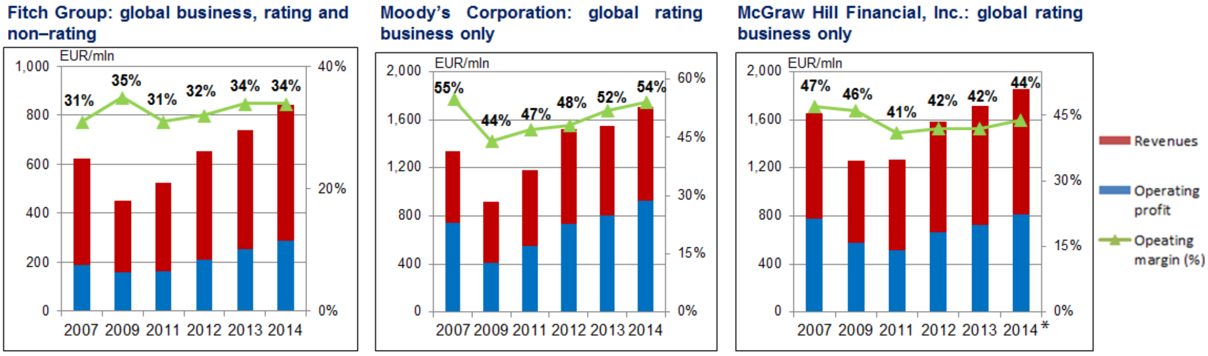
113. An analysis of the information available to ESMA suggests that the revenues from credit rating activities vary significantly between the CRAs operating in the EU. In general terms, the CRAs operating in the EU can be divided into three groups on the basis of the revenues from credit ratings and ancillary services reported to ESMA: those generating revenues of less than €1 million a year; those generating revenues of between €1 million and €26 million a year; and those generating revenues of over €100 million a year.

114. From the financial statements submitted to ESMA by 23 CRAs in 2014,[44] it appears that 5 CRAs fall into the first group, 15 fall into the second group and 3 fall into the third group. However, as revenue data is only made publically available by listed companies, ESMA presents only detailed information regarding the revenues generated by the groups of the three largest CRAs operating globally in the figures below.

115. Figure 10 below shows the relationship between the revenues, operating profits and operating margins of these three groups between 2007 and 2014.[45]

[44] ModeFinance was not registered as a CRA at the time these statements were submitted to ESMA.
[45] Please note that for Moody's Corporation (ultimate holding company of Moody's) and McGraw Hill Financial, Inc. (ultimate holding company of S&P) figures refer to the performance of rating business at global level. For the Fitch Group, figures refer to both rating and non-rating business combined at global level, since separate information for the credit rating business only is not publicly available.

Figure 10: Changes in the revenues, operating profits and the operating margins of three largest CRAs operating globally



Source: ESMA elaboration based on published consolidated accounts (figures from Fitch Group based on Fimalac's consolidated annual reports). Figures of Moody's Corporation and McGraw Hill Financial, Inc. have been converted to EUR from USD based on monthly average exchange rate.
* The 2014 figures for McGraw Hill Financial, Inc. do not take into account the impact of US legal and regulatory settlements on the group's operating profit and margins.

116. This figure shows that overall the revenues, operating profits and margins of these groups had returned to and exceeded 2007 levels by 2014. All three groups reported significant operating margins between 2009 and 2014. For Moody's these have increased slightly, from 44% to 54%, whereas for Fitch margins decreased from 35% in 2009 to 34% in 2014 and for McGraw Hill margins decreased from 46% to 44% over the same period.

117. However, this figure covers all of the operations of each of these groups. The proportion of the revenues generated from credit rating activities is presented in Table 3 below.

Table 3: Credit rating related revenues as a percentage of the total revenues generated by the three largest CRAs operating globally 2012-2014

Fitch Group - global revenues (Eur/mln)	**2012**	**2013**	**2014**
Rating related business	517	568	616
Non-rating related business *	138	172	225
Total Fitch Group global revenues	**654**	**740**	**841**
% of rating-related revenues	**79%**	**77%**	**73%**

* Including Fitch Solutions, Fitch Learning and BMI

Moody's Corporation - global revenues (Eur/mln*)	**2012**	**2013**	**2014**
Rating related business (MIS)	1,524	1,551	1,708
Non-rating related business (MA)	666	688	806
Total MCO global revenues	**2,189**	**2,239**	**2,514**
% of rating-related revenues	**70%**	**69%**	**68%**

* Amounts converted to Eur from USD based on monthly average exchange rate

McGraw Hill Financial, Inc. - financial segment global revenues (Eur/mln*)	**2012**	**2013**	**2014**
Rating related business	1,583	1,713	1,851
Non-rating related business **	1,177	1,252	1,349
Total MHFI global revenues	**2,759**	**2,965**	**3,200**
% of rating-related revenues	**57%**	**58%**	**58%**

* Amounts converted to Eur from USD based on monthly average exchange rate
** Including S&P Capital IQ and S&P DJ Indices

Source: ultimate holding companies' consolidated accounts

118. This table suggests that the revenues generated by these groups from credit rating activities account for over half of the groups' overall revenues. ESMA will be in a better position to assess the situation in respect of all CRAs once CRAs begin reporting their revenues from credit rating activities and ancillary services to ESMA in accordance with the Commission Delegated Regulation regarding the fees charged by CRAs.[46]

3.3 Market dynamics and competition in the CRA industry

3.3.1 Oligopolistic markets

119. The CRA industry has been described as oligopolistic, which means that it is served by only a small group of firms. Oligopolistic markets may be highly competitive, where firms compete on price or the amount of goods and services they provide.[47] However, some firms operating in oligopolistic markets may be able to exercise market power. Market power can allow firms to limit the amount or quality of the goods and services they provide and to charge high prices for those goods and services that they do produce.[48]

120. Firms operating in oligopolistic markets may be said to be interdependent as they are able to understand or predict the competitive positioning and strategy of the other

[46] Commission Delegated Regulation (EU) 2015/1 of 30 September 2014 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards for the periodic reporting on fees charged by credit rating agencies for the purpose of ongoing supervision by the European Securities and Markets Authority, OJ L 2, 6.1.2015 at pages 1–23, referred to in footnote 37 above.
[47] Carlton and Perloff, *Modern Industrial Design*, Fourth Edition, Chapter 6
[48] Concerns about market power are considered in more detail in Section 3.4 below.

firms in their industry to a certain extent. This can sometimes lead all firms in an industry to behave in similar ways rather than to compete aggressively against each other. Oligopolists may adopt similar approaches, for example to their investment in innovation, their product range, or the quality or pricing of their products and services. This may harm the users of the firms' products and services, for example where they are offered lower quality goods and services at higher prices than they would pay if faced with stronger competition.[49]

121. Theoretically, in the CRA industry potential harm could arise to those seeking and using credit ratings if all CRAs were to offer low quality goods and services at high prices and did not invest in innovation to develop their businesses. In addition, the competitiveness of European businesses could be harmed if it were to become too costly for some smaller issuers to seek the credit ratings they need, for example to raise money in the capital markets to finance their operations or their investments in research and development. In addition, the high fees charged for subscriptions to the data and research reports that investors need to carry out appropriate due diligence may dissuade some smaller investors from investing in rated entities or instruments.

122. In the EU, the co-legislators have taken specific measures with a view to minimising the potentially harmful effects of this industry structure through the CRA Regulation. These include the adoption of specific measures to reduce and manage conflicts of interest and ensure the independence and quality of credit ratings,[50] to stimulate competition between CRAs and to promote the use of smaller CRAs and new entrants.[51] These measures have also extended to the introduction of provisions designed to allow ESMA to oversee the fees charged by CRAs for credit ratings and ancillary services.[52]

3.3.2 Industry dynamics

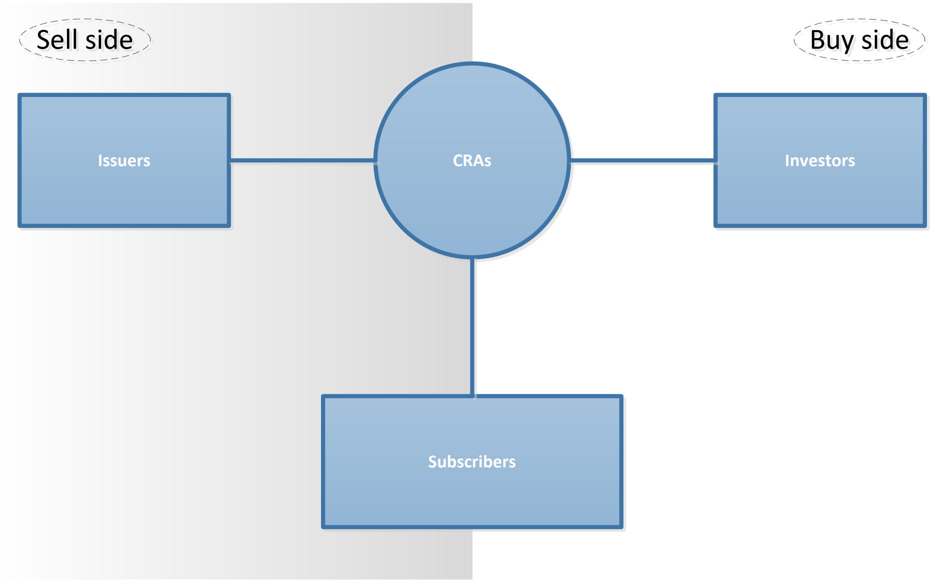
123. As explained in Section 3.1 above, CRAs offer products and services which are used by various different customer groups. The issuers and entities that provide the information needed to produce credit ratings and related products are on the supply side of the industry. On the demand side of the industry are the investors, intermediaries and entities who are the users of credit ratings and related services.

124. CRAs are able to generate revenues from customers on both the issuer or supply side (sell side) and the investor or demand side (buy side) of the industry. CRAs using the issuer-pays model would typically charge issuers for individual credit ratings which are then made available to investors free of charge. However, revenues are also being generated by charging subscribers, such as issuers, investors and other market participants for access to credit ratings databases, data feeds, research and reports.

125. Supply and demand are interdependent in these kinds of markets as the value of a CRA to the customers on the issuer side of the industry is influenced by the number and types of investors to which a CRA can provide access. In this way, each CRA operates as a platform which offers access to a network of issuers and investors as illustrated by the following diagram.

[49] See for example, Carlton and Perloff, *Modern Industrial Design*, Fourth Edition, Chapter 6; Whish and Bailey, *Competition Law*, Sixth Edition at pages 560-567; Geradin, Layne-Farrar and Petit, *EU Competition Law and Economics*, 2012 paragraph 2.49 and sources cited therein.
[50] As discussed in Section 4 below.
[51] See Section 5 below.
[52] As set out in Annex I Section B 3c of the 2013 amendments to the CRA Regulation referred to in Section 5 below.

Diagram 1: CRAs as platforms



Source: ESMA

126. Looking at the CRA industry as a series of platforms operated by different CRAs helps us to understand why the industry is characterised by the existence of only a few firms. Issuers want to use those CRAs which are recognised by the largest number of relevant investors and investors want to use the CRAs who can offer the greatest coverage of the issuers and instruments they are interested in.

127. The interdependent nature of demand in such industries can make effective regulation challenging as measures designed to improve the functioning of one part of the industry, such as fee supervision, will also impact, and may have unintended consequences for, other parts of the industry.[53] This has been widely recognised, including by Professor Jean Tirole, who has suggested that the role of the regulator in these kinds of industries should be to make sure that there is a level playing field for different platform operators, to ensure that they do not abuse their market power or use their market position to restrict market entry. This in turn helps to ensure that platform industries can operate in a way which serves the interests of the wider economy.[54]

3.3.3 Competition between CRAs

128. In industries characterised by the existence of multiple platforms, firms compete on the size and coverage of the network they can offer. In this way, CRAs compete to offer issuers exposure to the widest range of relevant investors and to offer investors broad coverage of rated entities and instruments.

[53] *Maximizing Competition in the Case of Two-Sided Markets*, Kaushal Sharma, Shanker Singham, Jul 27, 2010, Competition Policy International, available at: https://www.competitionpolicyinternational.com/maximizing-competition-in-the-case-of-two-sided-markets/, last accessed 26.08.2015.
[54] See for example, http://www.ft.com/cms/s/0/7c0f1c7a-5485-11e4-bac2-00144feab7de.html#axzz3hHfxGo8v, last accessed 29.07.2015.

129. Responses to the Call for Evidence from issuers and investors showed that they were not really aware that CRAs were actively competing with each other.[55] However, some recognised that CRAs could compete on a number of parameters. Quality, variety and the geographic coverage of the services offered were stated to be the biggest selling points of the largest CRAs operating globally. In addition, the fees charged for credit ratings and related services were also a factor.[56] These parameters were also identified by almost all of the CRAs that responded to the Call for Evidence.[57]

130. The CRA industry supports a number of competing platforms, with some smaller CRAs specialising in ratings of particular types of instrument or particular geographic areas and larger CRAs seeking to offer global coverage. This does not appear to have changed since the entry into force of the CRA Regulation in the EU.

131. Responses to the Call for Evidence confirm that many issuers and investors use more than one CRA.[58] This may be partially as a result of market preferences and partly due to regulatory measures requiring certain instruments to have multiple credit ratings.[59]

132. However, some respondents to the Call for Evidence noted that in their view they saw little benefit to more than a handful of CRAs offering ratings for all asset classes at EU level and a number of smaller specialist CRAs which can offer particular expertise in rating certain industries or instruments or in particular geographic areas.[60] ESMA notes that it is not uncommon for industries which accommodate competing platforms to tip towards monopoly as the industry reaches maturity and considers this issue in more detail in Section 3.5 below.

3.3.4 Barriers to market entry

133. Before a firm can start to compete against other firms in a given market, it must first enter that market. In many industries, it is not possible to simply start operating, due to the existence of barriers to market entry. These general barriers to entry can include legal barriers, such as compliance with regulation, as well as economic advantages such as economies of scale,[61] costs and network effects.[62] Some of the main entry barriers faced by firms wishing to establish themselves as CRAs are regulation, as well as the need to establish a customer base to overcome the network effects present in the industry.[63] These are presented in the paragraphs below.

134. In order to be registered as a CRA, firms need to be able to demonstrate compliance with the requirements of the CRA Regulation. ESMA assesses

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[55] Issuer responses to questions 25 and 26 of the Call for Evidence, Investor responses to question 26 of the Call for Evidence.
[56] CRA responses to question 19 of the Call for Evidence, Issuer responses to questions 25 and 26 of the Call for Evidence.
[57] CRA responses to question 19 of the Call for Evidence.
[58] Issuer responses to questions 3-5 of the Call for Evidence, Investor responses to question 16 of the Call for Evidence.
[59] See for example the requirement of Article 8c of the CRA Regulation, the impact of which is considered in Section 6 below.
[60] Issuer responses to questions 25 of the Call for Evidence, Investor responses to question 25 of the Call for Evidence.
[61] See Case 27/76 *United Brands* v *Commission* [1978] 1CMLR 429.
[62] See for example the Commission Notice, Guidance on its enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, OJ C 45, 24.2.2009, page 7–20 at paragraph 17 available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52009XC0224(01)&from=EN, last accessed 26.08.2015
[63] Investor responses to question 25 of the Call for Evidence, CRA responses to questions 20 and 23 of the Call for Evidence.

applications for registration in accordance with the Commission Delegated Regulation regarding regulatory technical standards for the registration and certification of CRAs.[64] In some cases, CRAs needed to invest in the development of methodologies and analytical capacity or appoint additional staff in order to fulfil the requirements for registration, for example to provide a supervisory board or to put in place an independent compliance function.[65]

135. Responses to the Call for Evidence also suggest that the on-going costs of compliance with the CRA Regulation are significant for a number of CRAs after registration. For example, some respondents highlighted the costs associated with establishing and updating the IT systems needed to provide reports to ESMA.[66]

136. The need to establish a network of customers has also been recognised by market participants as a barrier to entry. These kinds of barriers to entry are not uncommon in markets where supply and demand are interdependent. In general, respondents to the Call for Evidence explained that new entrants need to build up their reputation based on the quality of their credit ratings.[67] This will in turn help new entrants to gain acceptance amongst investors, which enables issuers to appoint them to rate their entities or instruments.[68]

137. The barriers to entry identified are necessary in order to ensure the issue of high quality independent credit ratings. Indeed, the standards imposed by the CRA Regulation are intended to prevent CRAs from reducing the quality of their credit ratings in order to win business, and so seek to avoid the recurrence of events which harmed issuers and users of SFI ratings during the financial crisis.

3.4 Market definition and market power

3.4.1 Market definition

138. As noted above, one of the key concerns arising in oligopolistic markets is that firms may be able to exercise market power to increase prices or reduce quality or output. Market definition exercises can be a useful tool in developing an understanding of industry dynamics by assessing the degree of competition which exists in particular markets.

139. Market definition exercises seek to establish the nature and scope of the market for a particular product or service and the geographic extent of that market. The extent of a product market can be established by determining which products and services are seen as interchangeable or substitutable in the eyes of the users of those products and services because of their characteristics, prices and intended uses. The geographic scope of a market for a particular product or service can then

[64] Commission Delegated Regulation 449/2012 of 21 March 2012 with regard to regulatory technical standards on information for registration and certification of credit rating agencies, OJ L 140/32 of 30.5.2012 referred to in footnote 30 above.
[65] CRA responses to question 17 of the Call for Evidence.
[66] CRA responses to question 17 of the Call for Evidence.
[67] Issuer responses to the Call for Evidence questions 25 and 26 Investor responses to the Call for Evidence question 25.
[68] Issuer responses to the Call for Evidence questions 25 and 26 Investor responses to the Call for Evidence question 25.

be established by determining the area in which the conditions of competition are sufficiently similar to each other.[69]

140. A hypothetical monopolist test is often used to carry out this assessment. The test asks the customers of a firm how they would respond to a small but significant increase in price of around 5-10% of a particular product or service. In general terms, if they would switch to another provider or another product or service or to a provider in another geographic area, then that product or service or that other geographic area should be considered as forming part of the same market.

141. It is recognised that the results of this test can be misleading in cases where firms have significant market power as they may already have raised prices significantly above competitive levels. This means that some customers may cease to buy from the firm, or to buy the product or service at all if faced with any further price increases. Care must be taken in interpreting the results of this test in such cases, as they may tend to suggest that other products are closer substitutes for the product or service in question than they actually are.

142. In the Call for Evidence, ESMA asked issuers and entities seeking credit ratings how they would respond to a 5-10% increase in the price of credit ratings.[70] In this case, only a few issuers said that they would consider switching to an alternative CRA in response to a 5-10% increase in the prices of credit ratings.[71] A number said that they would challenge a further increase in fees and try to negotiate but expressed concerns that they would ultimately be forced to accept such an increase.[72]

143. Recent price increases by the three largest CRAs operating globally could be used as a natural experiment for these purposes as more than half of the issuers who responded to the Call for Evidence reported increases in fees ranging from 1% a year to 300% between 2010 and 2015.[73] Although a number of issuers said they would consider using an alternative CRA in response to a 5-10% increase in price in principle; it appears that none of the issuers surveyed actually did so in practice.[74]

144. This suggests that there may be markets for individual credit ratings sought by issuers. This is understandable as the type of rated instrument chosen by an issuer or investor is important to them and is selected by them to meet a specific need, for example to raise funds or to comply with the terms of an investment mandate. It could therefore be argued that markets for credit ratings should be defined by type of entity rated or type of instrument rated within an asset class.

145. In terms of the geographic markets for credit ratings, there was no suggestion in the responses to the Call for Evidence that issuers would switch to a CRA offering credit ratings in a different geographic area in response to a 5-10% increase in

[69] The European Commission and National Competition Authorities regularly carry out such exercises as a part of their competition ingestions. More information about the market definition exercise they use is available in the Commission notice on the definition of the Relevant Market for the purposes of Community competition law, OJ C 372, 09.12.1997, at page 5, last accessed 29.07.2015.

[70] The Call for Evidence and the market definition exercise considered below relates only to issuer-pays credit ratings, given that the investor-pays model is not currently as widely used as the issuer- pays model. However, the same principles could be applied in order to determine the scope of the markets for investor-pays ratings and ratings issued by subscription.

[71] Issuer responses to question 9 of the Call for Evidence.

[72] Issuer responses to question 9 of the Call for Evidence.

[73] Issuer responses to questions 8 and 9 of the Call for Evidence.

[74] Issuer responses to question 9 of the Call for Evidence.

price.[75] Indeed, it appears that the type and the location of the entity issuing or investing will have an impact on the CRA from which they would seek a credit rating. For example, an SME based in Italy might be unlikely to seek a credit rating from a CRA which did not operate in Italy on account of their knowledge of local market conditions and regulations as well as for practical and linguistic reasons. Similarly, companies operating in a number of different EU Member States might be likely to seek credit ratings from CRAs with a wider reach so as to be able to attract investors from multiple Member States. In addition, entities operating internationally and wishing to attract global investors may seek credit ratings from CRAs which could offer access to these kinds of investors.

146. On this basis, it seems that there may be different types of geographic market to consider. There are national markets within the EU, for example for SME issuers seeking credit ratings on their entities and instruments who wish to attract local investors in their Member State. There are also international markets for companies and issuers who seek credit ratings on their entities and instruments to attract investors throughout the EU as well as internationally.

3.4.2 Market power

147. One reason for considering the extent of the different product and geographic markets which might exist in the CRA industry is to assess whether the CRAs active in each of these markets are able to exercise market power. A firm has market power if it is able to profitably raise prices above competitive levels over time or to restrict the choice or quality of products and services available.

148. Where a firm is able to exercise significant market power, they may be found to hold a dominant position in individual product or geographic markets within the EU. Holding a dominant position means that a firm has a special responsibility under Article 102 of the Treaty on the Functioning of the European Union (TFEU) not to allow its conduct to impair genuine undistorted competition.[76] Article 102 of the TFEU gives a number of examples of conduct which may amount to an abuse of a dominant position including imposing unfair prices or trading conditions on customers, or limiting markets or technical development to the prejudice of consumers.[77]

149. Market shares can be a useful first indication of whether a firm might have market power and be found to have a dominant position in a given product market or geographic area for the purposes of the application of EU competition law. As every industry is different, there are no set rules as to the level of market share which is indicative of a dominant position. However, the case law of the Court of Justice recognises that a market share of 50% may indicate that a firm holds a dominant position[78] and that, depending on the nature of the market in question, a 40% market share may be indicative of a dominant position.[79]

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[75] Issuer responses to question 9 of the Call for Evidence.

[76] Case 322/81 *NV Nederlandsche Banden Industrie Michelin* v *Commission of the European Communities* [1983] ECR 3461 at paragraph 57.

[77] Consolidated version of the Treaty on the Functioning of the European Union OJ C 326, 26.10.2012, pages 47–390, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12012E/TXT&from=EN, last accessed 03.09.2015.

[78] Case C-62/86 [1991] *AKZO* v *Commission* [1991] ECR I-3359, [1993] 5 CMLR at paragraph 60.

[79] Case C-95/04P *British Airways plc* v *Commission* [2007] ECR I-2331 [2007] 4 CMLR 982.

150. The market shares of CRAs can be calculated by reference to the number of credit ratings sold in the relevant product and geographic market or the revenues generated from credit ratings provided in those markets. For the purposes of this Technical Advice ESMA has used each CRA's share of supply of the total ratings reported under the categories of asset classes used by the CEREP database as an estimate of their likely market shares. The tables presented here are therefore subject to the caveats provided regarding the scope of the CEREP data highlighted above, that data relating to SFIs and covered bonds are reported at issue level whereas for all other categories, data is reported at issuer level.[80]

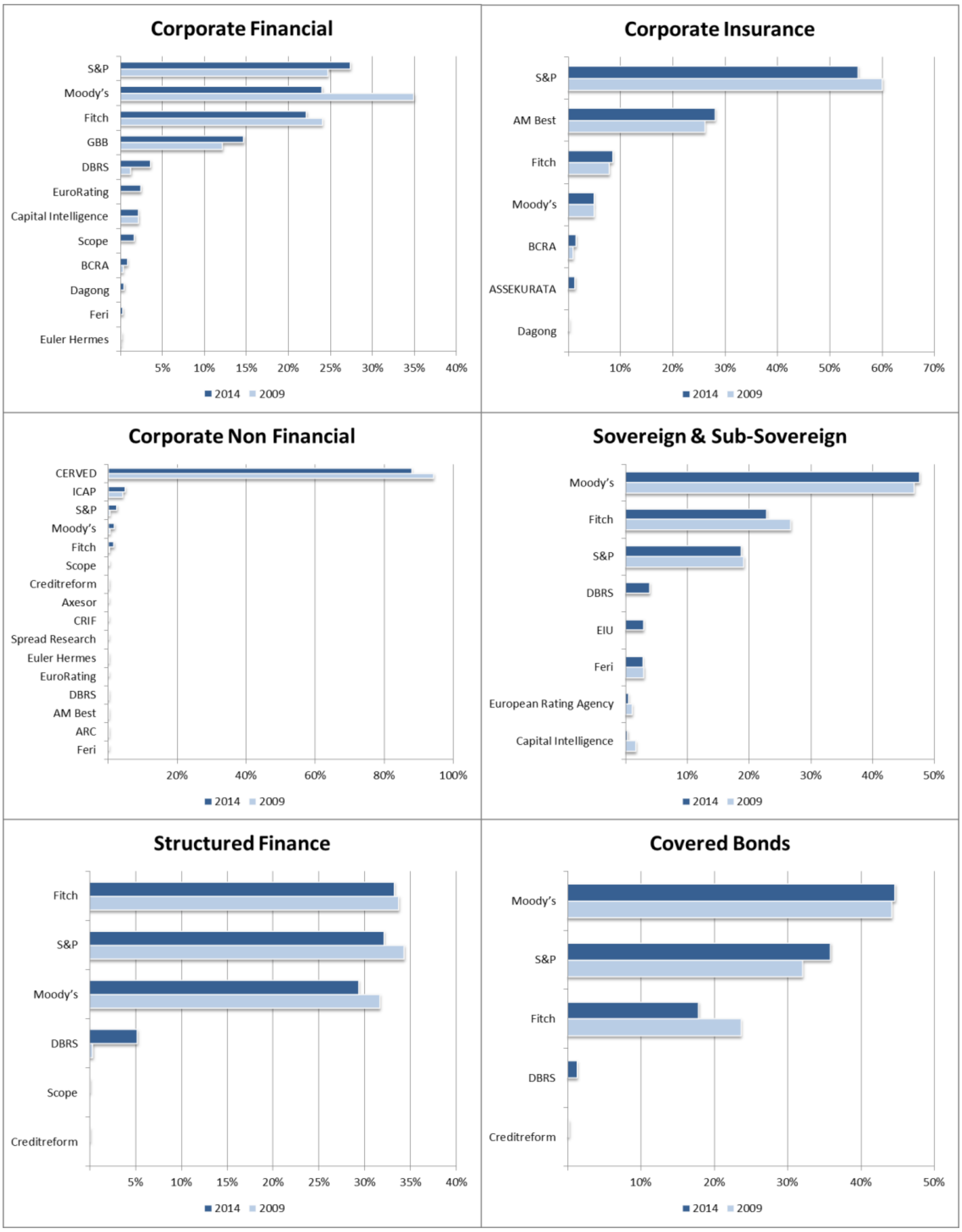
151. Although this does not allow for the calculation of the share of supply in all of the product and geographic markets identified in Section 3.4.1 above, responses to the Call for Evidence suggest that these wider categories may still be meaningful as they are used by the largest CRAs operating globally to track their competitive positions.[81]

152. Once CRAs start reporting to ESMA pursuant to Commission Delegated Regulations regarding the European Rating Platform[82] and regarding the fees charged by CRAs,[83] ESMA will be provided with data which will allow it to calculate each CRA's share of the credit ratings issued for each instrument within an asset class and the revenues generated from each asset class.[84]

153. Figure 11 below shows the evolution of CRAs' EU wide share of supply of credit ratings outstanding for each of the categories of asset class reported to CEREP.

[80] See Section 3.2 above regarding the data reported at issuer level for corporate and sovereign and sub sovereign credit ratings and at issue level for the other CEREP categories.
[81] CRA responses to questions 21 and 22 of the Call for Evidence.
[82] Commission Delegated Regulation (EU) 2015/2 of 30 September 2014 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards for the presentation of the information that credit rating agencies make available to the European Securities and Markets Authority, OJ L 2, 6.1.2015, p. 24–56, available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0002&from=EN, last accessed 26.08.2015.
[83] Commission Delegated Regulation (EU) 2015/1 of 30 September 2014 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards for the periodic reporting on fees charged by credit rating agencies for the purpose of ongoing supervision by the European Securities and Markets Authority, OJ L 2, 6.1.2015, p. 1–23 referred to in footnote 38 above.

Figure 11: EU-wide share of supply for each CEREP category



Source: CEREP, ESMA

154. This figure shows that the three largest CRAs operating globally have the highest shares of supply in the corporate financial, sovereign and sub-sovereign, structured finance and covered bond categories. This reflects the overall EU-wide market share calculations for the purposes of Article 8d, which are carried out on the basis of

revenues generated from credit rating activities and ancillary services rather than on the number of credit ratings outstanding.[85]

155. However the share of supply charts are also able to provide further insights. They demonstrate how the three largest CRAs are stronger in some areas than others, with S&P holding the largest share of supply for corporate insurance and corporate financial credit ratings and Moody's holding the largest share of sovereign and sub-sovereign credit ratings and rated covered bonds. Fitch holds around a 20% share of supply of credit ratings issued in most of these categories, although it has a higher share of structured finance ratings and a significantly lower share of corporate insurance ratings, where it supplies less than less than 10% of ratings according to the CEREP data.

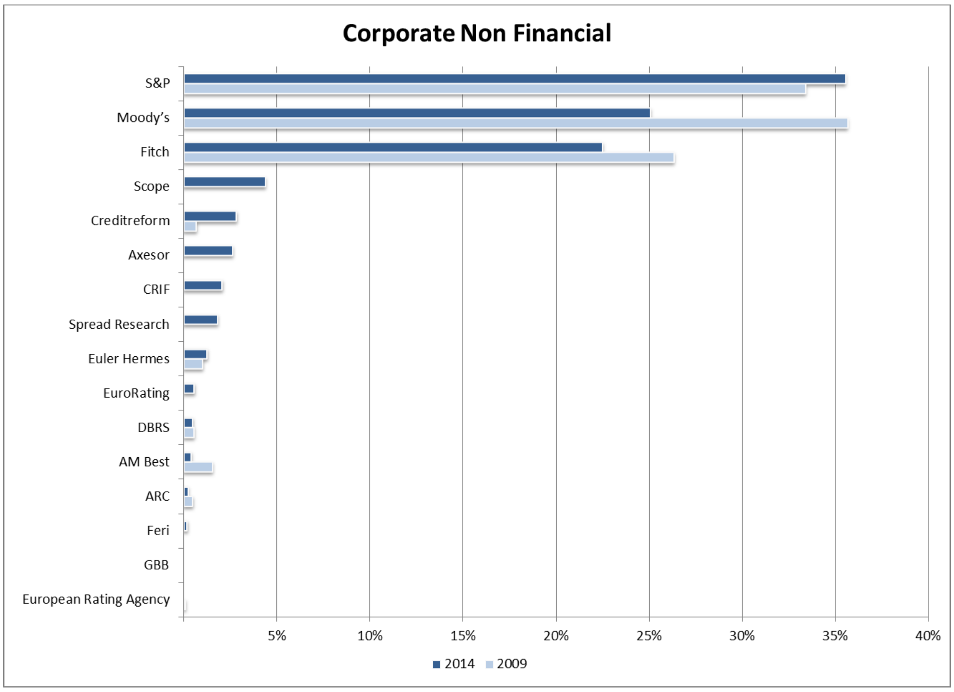
156. The charts also show that other CRAs have a relatively large share of the supply of ratings for certain categories such as GBB in the corporate financial category[86] and AM Best in the corporate insurance category.

157. Regarding the corporate non-financial category, as noted in Section 3.2 above, the proportion of outstanding credit ratings appears much higher for CRAs whose customer base consists mainly of smaller corporations. To address this issue, the following figure therefore provides the share of supply of corporate non-financial credit ratings issued by all CRAs registered in the EU excluding CERVED and ICAP.

[85] ESMA2014/1583 Credit Rating Agencies Market Share Calculations for the purposes of Article 8d of the CRA Regulation, 22 December 2014, available at: http://www.esma.europa.eu/system/files/2014-1583_credit_rating_agencies_market_share_calculation_2014.pdf, last accessed 29.07.2015.

[86] ESMA notes however that these ratings are a condition for inclusion in the deposit protection fund required by German law.

Figure 12: Share of supply of corporate non-financial ratings issued by all CRAs excluding CERVED and ICAP



Source: CEREP, ESMA

158. This chart shows that once CERVED and ICAP are removed, the three largest CRAs operating globally also supply the vast majority of corporate non-financial credit ratings. Scope is also starting to make an impact in this category, with an almost 5% share of supply in 2014.[87]

159. The charts show how the share of supply for each category of credit ratings has evolved between 2009 and 2014. In general, they show that smaller CRAs and new entrants have been increasing their share of supply in most categories, with the exception of structured finance and covered bond ratings, where DBRS has started to supply a small number of the total credit ratings outstanding. On the basis of the information available, it appears that smaller CRAs and new entrants have made the most impact in the corporate financial and non-financial segments during this period.

160. Given the scope of the CEREP data as highlighted in Section 3.2 above, it is difficult to draw any firm conclusions from these charts as to the degree of market power CRAs are able to exercise in different categories of credit ratings. However, responses to the Call for Evidence showed that most issuers obtain two credit ratings for some types of instrument[88] and some obtain three.[89] This may suggest that in some cases the three largest CRAs operating globally may all be issuing credit ratings on certain instruments or entities, which could mean that there is little effective competition between them.

161. As noted in subsection 3.4.1 above regarding market definition, the responses to the Call for Evidence regarding price increases seem to reflect that the three largest

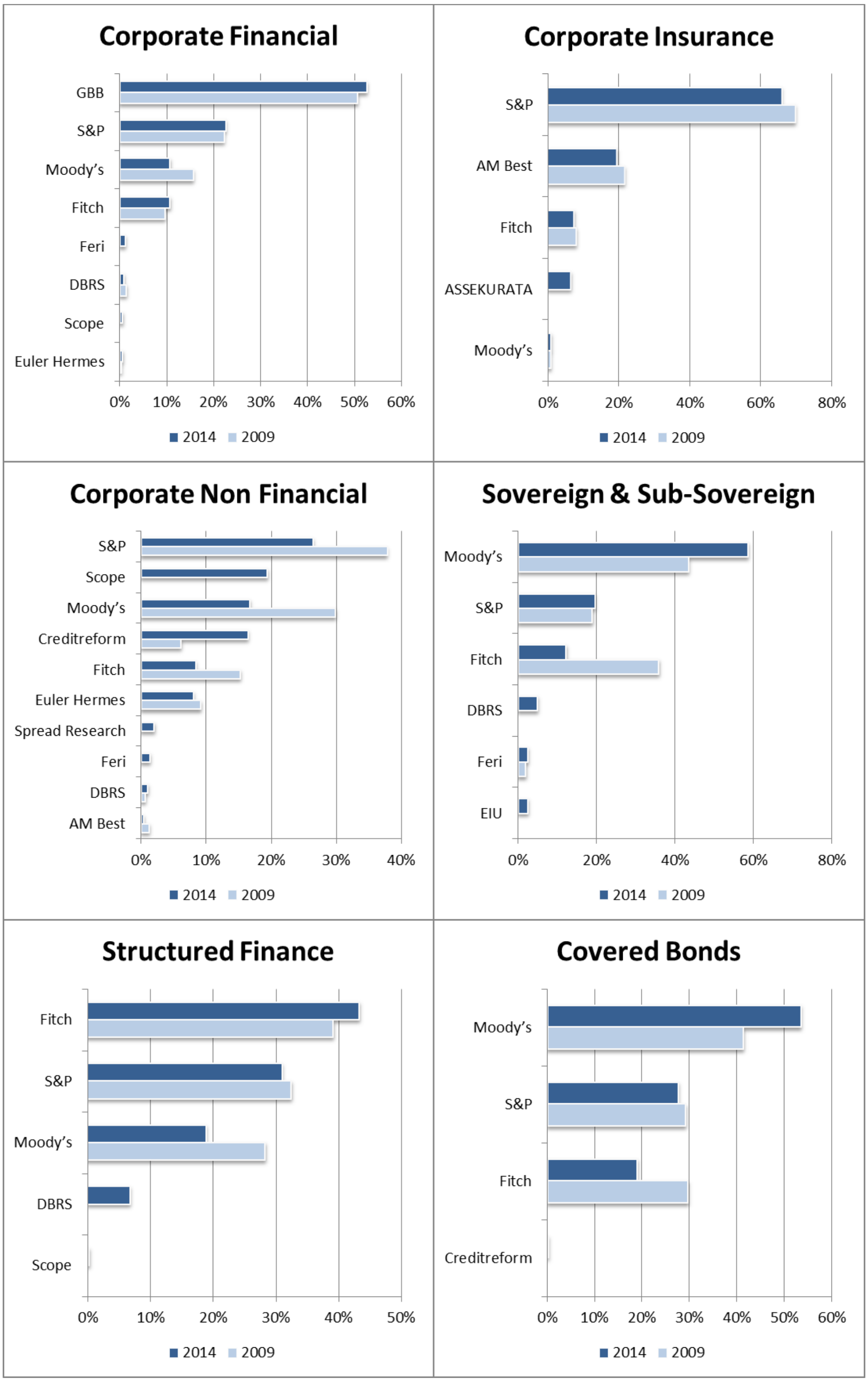
[87] Please note that this is revised data submitted by Scope which will be included in the next update of the CEREP database.
[88] Issuer responses to questions 3-5 of the Call for Evidence.
[89] Issuer responses to questions 3-5 of the Call for Evidence.

CRAs operating globally are able to impose regular price increases on their customers without this resulting in a significant loss of business, which tends to suggest that these CRAs have a certain amount of market power within the EU.

162. ESMA has considered CRAs' share of the supply of credit ratings in each Member State within the EU in order to better understand which CRAs might be able to exercise market power in each of these geographic markets. The following figures present the results of this exercise for the five EU Member States with the largest number of outstanding credit ratings in the CEREP database. They present the situation in 2009 and 2014 in order to demonstrate how the markets have changed over time.

163. Figure 13 below shows each CRA's share of supply for each category of credit ratings reported to CEREP for Germany in 2009 and 2014.

Figure 13: Germany – Share of supply for each CEREP category by CRA in 2009 and 2014



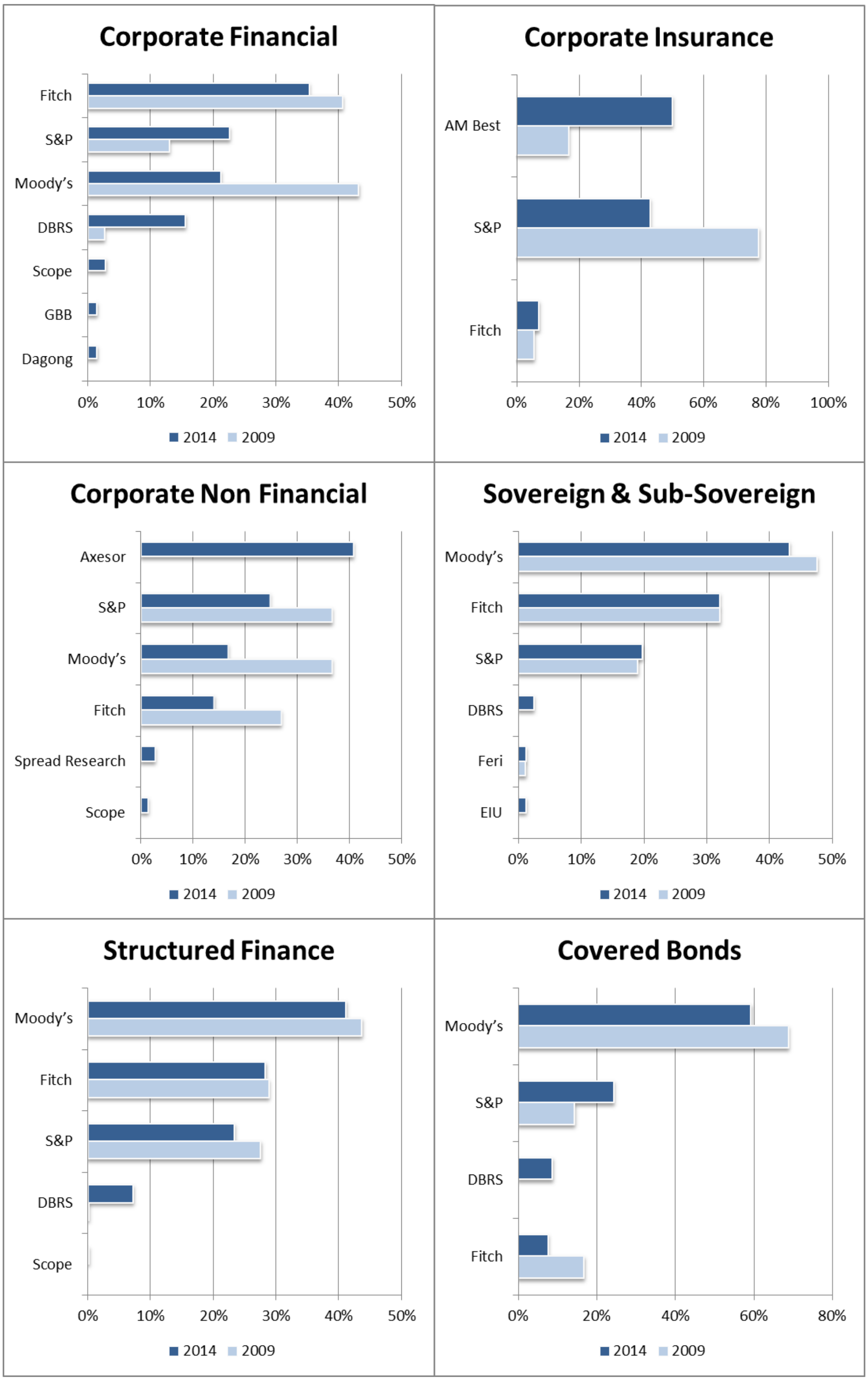
Source: CEREP, ESMA

164. The figure shows that in both 2009 and 2014 GBB had by far the highest share of supply of corporate financial ratings in Germany.[90] During this period S&P was the market leader in the corporate insurance category, with AM Best holding the second largest share of supply at around 20%. S&P was also the market leader in the corporate non-financial category in 2014. Scope developed a strong position in this category, with almost 20% of the total share of supply in 2014.[91] Creditreform also performed well here, with a 15% share of supply in 2014. Moody's was the market leader for the supply of covered bond ratings during this period whereas Fitch rated the largest amount of SFIs.

165. Figure 14 below shows each CRA's share of supply for each category of credit ratings reported to CEREP for Spain in 2009 and 2014. It shows Moody's was the market leader in three categories during this period with over 40% of the share of supply of sovereign and sub-sovereign ratings and structured finance ratings and nearly 60% of covered bond ratings. In 2014 Fitch supplied the highest number of corporate financial ratings in Spain, although DBRS had an approximate share of supply of 15% in this category in 2014. AM Best became the biggest provider of corporate insurance ratings during this period and Axesor gained a 40% share of supply in the corporate non-financial ratings category.

[90] See footnote 78 above regarding the position of GBB.
[91] Please note that this is revised data submitted by Scope which will be included in the next update of the CEREP database.

Figure 14: Spain – Share of supply for each CEREP category

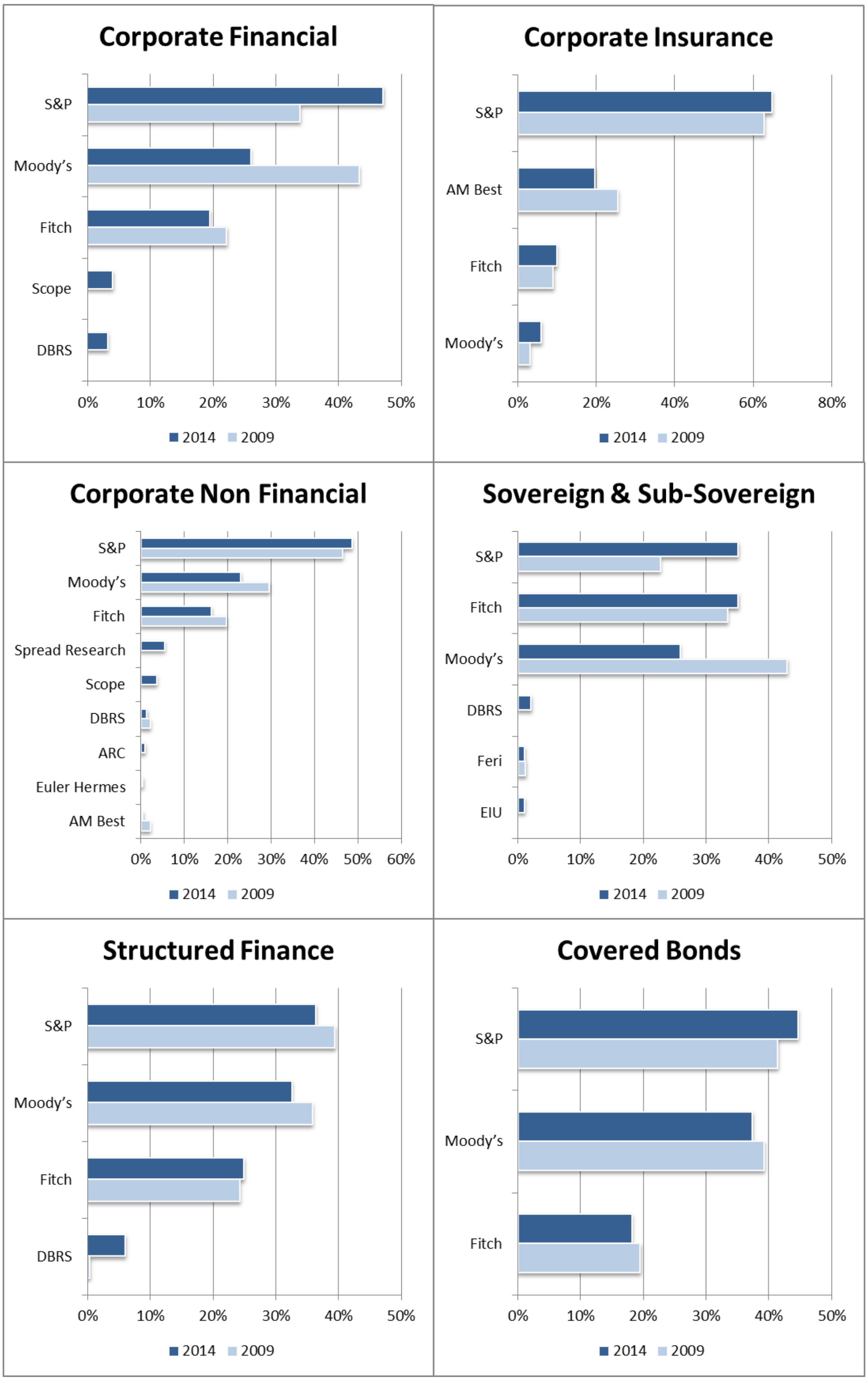


Source: CEREP, ESMA

166. Figure 15 below shows each CRA's share of supply for each category of credit ratings reported to CEREP for France.

167. In 2014, S&P held the largest share of supply in all six CEREP categories in France, ranging from 36% in the structured finance category to over 60% in the corporate insurance category. AM Best performed well in the corporate insurance category here with nearly 20% of the share of supply. DBRS entered the corporate financial, corporate non-financial, sovereign and structured finance categories during this period and Scope has also entered the corporate financial and corporate non-financial categories.

Figure 15: France – Share of supply for each CEREP category

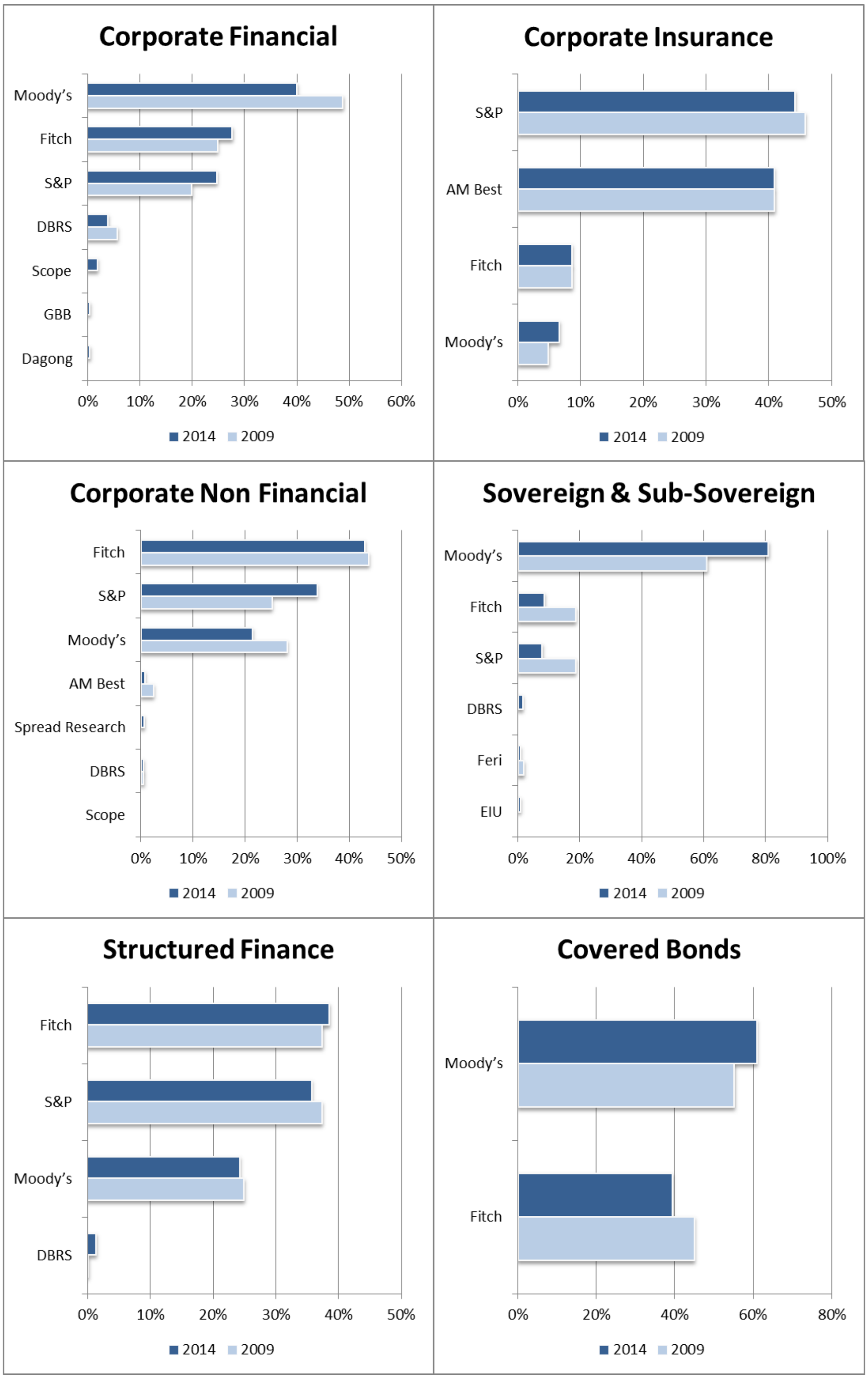


Source: CEREP, ESMA

168. Figure 16 below shows each CRA's share of supply for each category of credit ratings reported to CEREP for the United Kingdom.

169. This figure shows that Moody's held the largest share of supply in three categories during this period: corporate financial, sovereign and sub-sovereign and covered bonds. In this category, only two CRAs are active in the UK with Moody's holding a share of supply of around 60% during this period and the remainder being held by Fitch. S&P was the market leader in the corporate insurance category during this period, where AM Best also held a share of supply of around 40%. Fitch held the largest share of supply in the corporate non-financial and structured finance categories during this period.

Figure 16: United Kingdom – Share of supply for each CEREP category

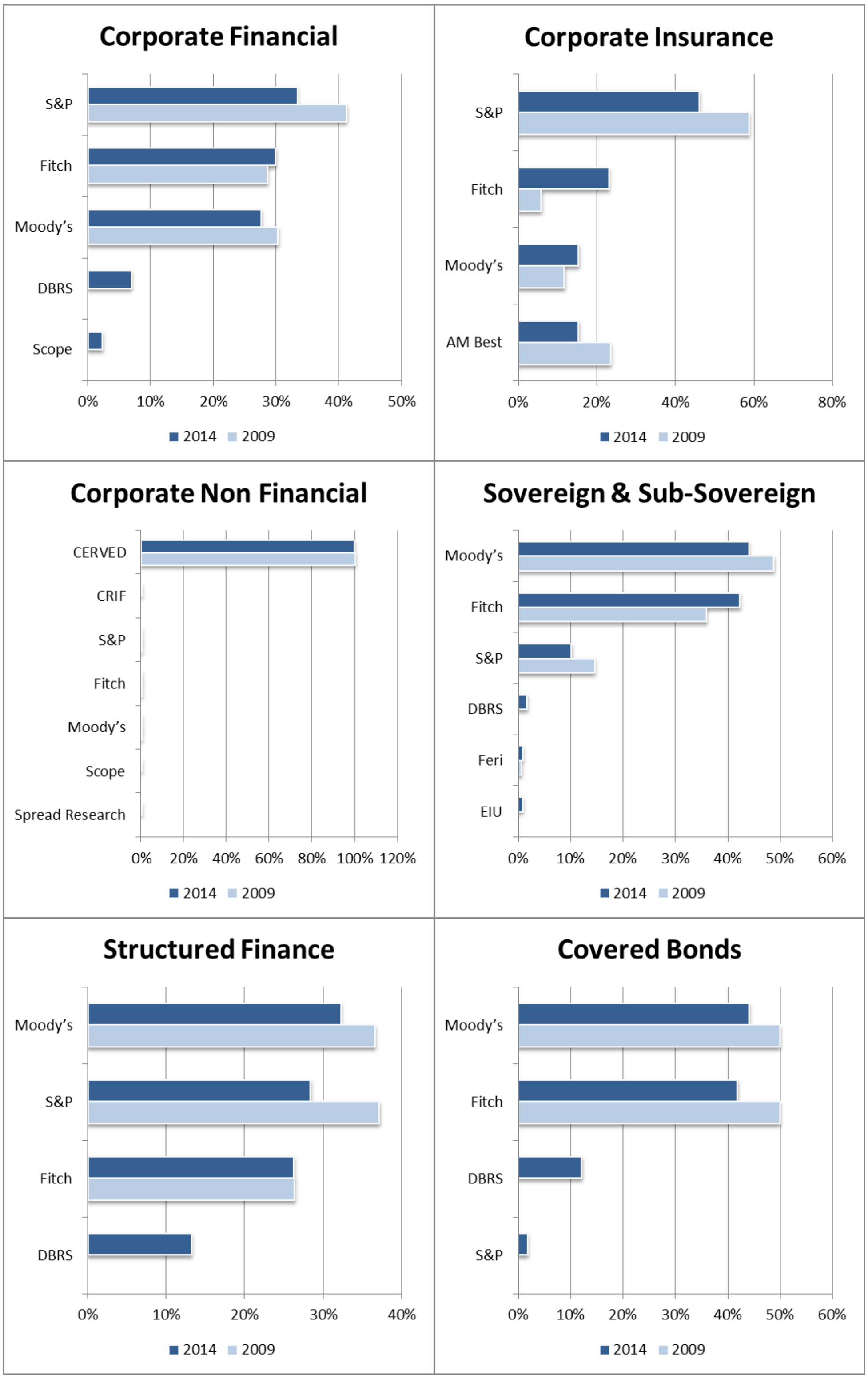


Source: CEREP, ESMA

170. Figure 17 below shows each CRA's share of supply for each category of credit ratings reported to CEREP for the Italian geographic market.

171. This shows that S&P held the largest share of supply in the corporate financial and corporate insurance categories between 2009 and 2014 and that Moody's held the largest share of supply in the sovereign and sub-sovereign, structured finance and covered bond categories. DBRS has also made an impact in the Italian market, mostly in the structured finance and covered bond categories where it held more than 10% of the share of supply in 2014, but also in the corporate financial category.

Figure 17: Italy – Share of supply for each CEREP category



Source: CEREP, ESMA

172. Overall, these figures suggest that some CRAs with an overall market share of less than 10% according to the calculations made for the purposes of Article 8d[92] hold a significant share of supply in certain rating categories in some Member States. In practice, this could have the unintended consequence of undermining the aims of Article 8d in certain product and geographic markets to promote the use of smaller CRAs and new entrants.

3.5 Industry concentration levels and associated risks

173. Markets in industries where only a few firms are operating are naturally quite concentrated. High concentration levels can be a concern from a competition perspective as firms operating in highly concentrated markets do not have strong incentives to compete on price or the quality of their products and services and have little incentive to innovate as the investment this requires could reduce their profit margins in the short term.

174. High concentration levels are not uncommon in platform markets. Mature platform markets are usually dominated by a handful of firms. This may create a stable oligopoly where there is little competition between platforms or may result in fierce competition between the leading firms. This competition may take place on a number of different parameters such as investment in innovative technologies or high quality customer service.

175. However, this kind of competition may also result in a *'winner takes all'* situation, where demand migrates to a single platform. This occurs where virtually all market participants adopt the same single platform or format in order to be connected to the largest network. Real life examples of this kind of competition are seen in the market for PC operating systems or in the adoption of the DVD format.[93]

176. As CRAs' core business is opinions about creditworthiness, the risk of the industry tipping towards monopoly may be lower than in other platform markets, as long as market participants continue to value more than one opinion or more than one methodology. It is too soon to determine how many platforms the industry will support in the long run, but a number of responses to the Call for Evidence suggest that there may only be a need for 4-5 CRAs to operate in each asset class as beyond a small number, there are few marginal benefits to additional credit ratings.[94]

177. Although the number of CRAs offering credit ratings of the major asset classes at EU level has increased in recent years, the analysis in Section 3.2.4 above shows that the CRA industry in the EU remains quite highly concentrated as just three or four CRAs are rating the vast majority of entities and instruments in some asset classes at EU level.

178. At Member State level, markets for credit ratings appear to be similarly concentrated for the most part, particularly in the markets for rated SFIs and covered bonds. An exception to this may be seen in the German market, where a number of

[92] ESMA2014/1583 Credit Rating Agencies Market Share Calculations for the purposes of Article 8d of the CRA Regulation, 22 December 2014, referred to in footnote 77 above.
[93] See for example *Strategies for Two-Sided Markets*, Eisenmann, Parker and Van Alstyne, Harvard Business Review, October 2006.
[94] Issuer responses to question 2-5 of the Call for Evidence and Investor response to question 25 of the Call for Evidence.

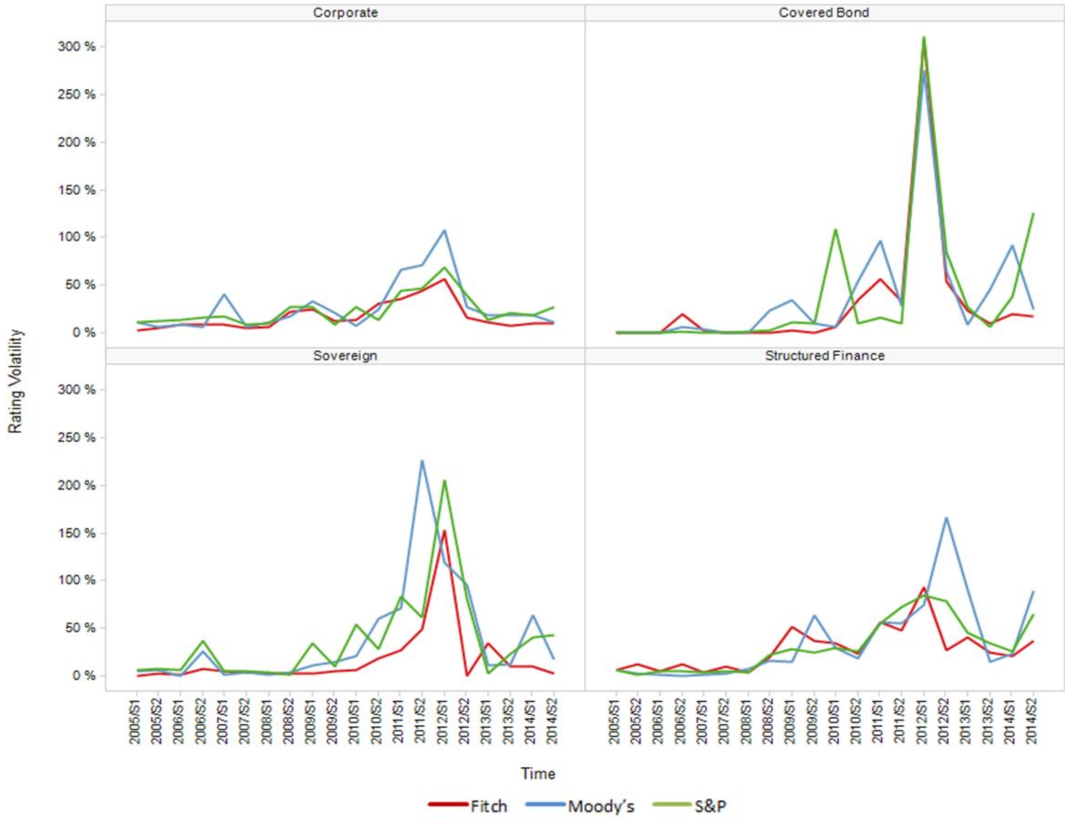
smaller CRAs are now starting to compete with the larger CRAs operating in the EU to issue ratings in most categories.

179. In financial services industries, high market concentration levels can create concerns from a financial stability perspective. In the CRA industry, risks to financial stability can be created where most market participants rely on only a very few opinions and behave in similar ways in response to changes in market conditions, for example by selling their investments in response to a downgrade by a CRA.

180. In oligopolistic markets, firms often make decisions about their strategy on the basis of the decisions that they think their competitors will make. In theory, this means that CRAs might be influenced by their understanding of how other CRAs would be likely to respond to changing market sentiment.

181. An examination of ratings volatility (the frequency of rating changes) and ratings drift (the direction of rating changes) may help to understand whether such oligopolistic interdependence can be seen in the markets for credit ratings. Figure 18 below uses CEREP data to show changes in the ratings volatility of the three largest CRAs operating globally in the corporate, sovereign, covered bond and structured finance segments of the markets in Portugal, Italy, Ireland, Greece and Spain over time.

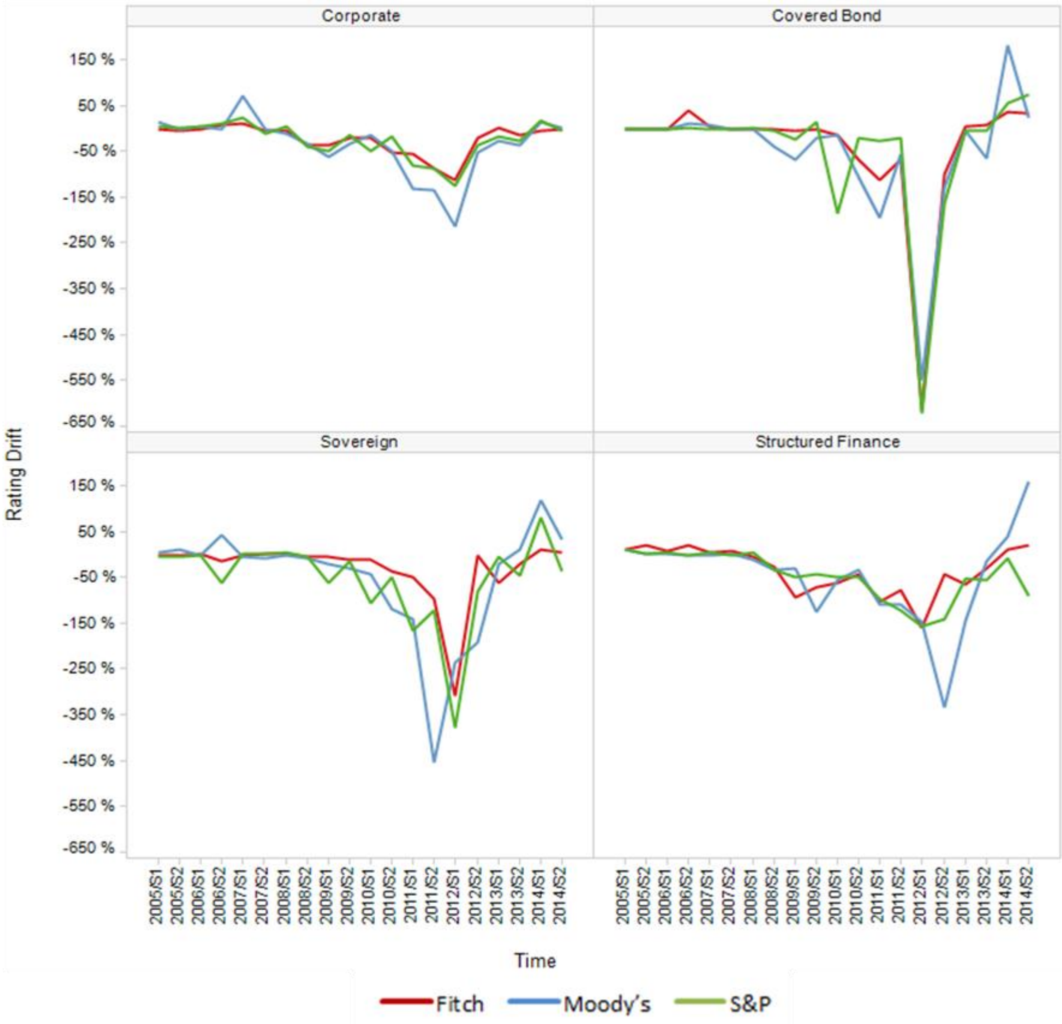
Figure 18: Ratings volatility of selected Member States over time



Source: CEREP, ESMA

182. Figure 19 below then shows the differences in ratings drift of the same selected Member States over time.

Figure 19: Ratings volatility of selected Member States over time



Source: CEREP, ESMA

183. Although not perfectly aligned, the graphs show that the CRAs are reaching similar opinions about the creditworthiness of these entities and instruments within a similar time scale. Looking at volatility here shows changes in ratings, and looking at the ratings drift demonstrates the direction of the change. For example, from a consideration of the changes to sovereign ratings during the peak of the sovereign debt crisis in 2012, it is clear that each of the three largest CRAs operating globally changed their opinions and downgraded their ratings quite dramatically within a similar period to become more conservative.

184. ESMA conducts regular market monitoring in order to identify potential risks to financial stability. As market monitoring is a key part of ESMA's risk-based approach to supervision, ESMA will continue to monitor changes in market dynamics and levels of concentration in different markets within the CRA industry going forward.

4 Impact of CRA Regulation on conflicts of interest and the use of alternative remuneration models

4.1 Objectives of provisions

185. In its assessment of the causes of the financial crisis, the Commission identified a number of areas where the structure of the CRA industry and the predominant use of the issuer-pays model may have affected the quality of credit ratings, particularly in the markets for ratings of SFIs.

186. The Commission's 2011 Impact Assessment[95] identified that under the issuer-pays model, CRAs had a financial incentive to generate business from rated issuers. It noted that adopting a business model which focuses on issuers creates a risk that CRAs might issue overinflated ratings in order to increase or keep issuers' business or that larger issuers might be able to use their bargaining power to obtain higher ratings.[96] This Impact Assessment noted particular concerns raised that larger issuers of SFIs may have received more favourable ratings than smaller issuers during the peak period of the economic cycle on this basis.

187. As part of its analysis of potential policy solutions, the Commission considered the merits of alternative remuneration models. It considered the investor-pays and subscription models being used by CRAs as well as a number of hypothetical models which could be used to avoid the conflicts of interest inherent in the issuer-pays model.

188. The Commission ultimately decided not to propose a requirement for CRAs to use particular remuneration models and the 2013 amendments to the CRA Regulation instead sought to reduce the conflicts of interest in the industry by introducing: rotation rules for CRAs engaged by issuers; specific requirements to enhance CRAs' objectivity and independence from their shareholders; stronger rules on disclosure of credit rating methodologies and requirements for CRAs to inform issuers in advance of issuing a credit rating.[97]

189. The requirements of the CRA Regulation supported and formalised many of the measures of self-regulation already undertaken by CRAs, for example through their adherence to the International Organization of Securities Commissions (IOSCO) Code of Conduct Fundamentals for Credit Rating Agencies. This code included provisions relating to the quality and integrity of the credit rating process, independence and the avoidance of conflicts of interest and CRAs' responsibilities to issuers and the investing public.[98]

190. This Section will consider the impact of CRAs' remuneration models as well as the particular provisions introduced to help mitigate conflicts of interest in Articles 6, 7 and 8 of the CRA Regulation and the related provisions of Annex I of the Regulation. The mandatory rotation provision set out in Article 6b of the CRA Regulation and its

[95] Commission Staff Working Paper, Impact Assessment Proposal for a Regulation amending Regulation (EC) No 1060/2009 on credit rating agencies, SEC (2011)1354, referred to in footnote 30 above.
[96] *Ibid* at page 19.
[97] *Ibid* page 53.
[98] IOSCO Code of Conduct Fundamentals for Credit Rating Agencies Final Report Revised May 2008, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf, last accessed 26.08.2015. The Code of Conduct was most recently revised in March 2015.

ability to achieve the objectives of mitigating conflicts of interest and stimulating competition will be considered in Section 6 of this Technical Advice.

4.2 Remuneration models

191. As noted above, the Commission reviewed a number of different remuneration models, from issuer-pays models to trading venue-pays models, as a part of its 2011 Impact Assessment, in considering the difficulties associated with the issuer-pays model. Some of these models are currently being used, whilst others have not been implemented to date.

192. The issuer-pays model and the investor and subscriber-pays models were described in Section 3 above. As explained in that section, the issuer-pays model is currently the most frequently used in practice. Responses to the Call for Evidence suggest that there are a number of reasons for this. One respondent noted that the issuer-pays model benefits smaller companies by helping them to access debt capital markets as it allows them to attract investors who would not necessarily seek a credit rating for that particular issuer or entity otherwise.[99] One CRA also noted that the issuer-pays model helped to increase the depth of capital markets by providing a transparent and globally understood measure of credit risk available to all market participants.[100]

193. Many responses to the Call for Evidence highlighted that the conflicts of interest inherent in the issuer-pays model could be appropriately identified and managed through sound governance by the CRA. [101] One respondent noted that the financial crisis exposed problems in CRAs' ratings of structured products such as Collateralised Debt Obligations (CDOs) and Collateralised Loan Obligations (CLOs).[102] On this basis, the requirements introduced by the CRA Regulation relating to conflicts of interest, and in particular the requirement that rating analysts should not be involved in providing advice on product design, should be sufficient to address the concerns raised. Indeed, a number of respondents noted that the main driver should be the need for high quality credit ratings, rather than a need to change how CRAs are paid for issuing credit ratings.[103]

194. Under investor-pays models, the investor pays for a rating to be issued, rather than the entity seeking the rating. Credit ratings were largely issued under investor-pays models until the 1970s. The switch to issuer-pays ratings during this period has been linked to liquidity shortages amongst issuers, which fuelled their willingness to pay for credit ratings as well as to the increasing use of photocopying machines, which allowed rating reports to be widely distributed and reduced many investors' willingness to pay for credit ratings.[104]

195. In considering the merits of the investor-pays model, the Commission identified that it may also give rise to potential conflicts of interest. It noted the risk that a large investor might try to influence a CRA to provide lower initial ratings so that their

[99] Issuer response to questions 11 and 12 of the Call for Evidence.
[100] This was contrasted with investor-pays models which could lead to a reduction in market size if investors are not willing to pay for ratings of particular instruments or entities, as explained below.
[101] Issuer responses to questions 11 and 12 of the Call for Evidence.
[102] Investor responses to question 5 of the Call for Evidence.
[103] Issuer responses to questions 11 and 12 of the Call for Evidence, Investor response to question 12 of the Call for Evidence.
[104] Investor responses to question 12 of the Call for Evidence, Issuer responses to questions 11 and 12 of the Call for Evidence.

investment could generate higher yields. It noted that the opposite risk is also possible, as bank investors may push to obtain the highest rating possible for regulatory capital reasons. A further risk noted was that smaller issuers could be marginalised if investors were not willing to pay for ratings of their entities or instruments.[105]

196. These investor-pays models are currently used by a number of CRAs together with issuer-pays or subscription models as explained in Section 3 above. This may be indicative of concerns raised in some of the responses to the Call for Evidence that investor-pays models have not been commercially viable on a stand-alone basis since the 1970s.[106]

197. In their response to the Call for Evidence, the European Association of Credit Rating Agencies noted that they see a number of different business models are being used by their members, including hybrid models, where credit ratings are issued to some clients under the issuer-pays model and others under the investor-pays model or on a subscription basis. They explained that some CRAs might even use different business models in different markets as a matter of strategy. However, this was not widely recognised by issuers and investors. For example, one association representing investors noted the lack of CRAs operating under investor-pays business models and expressed concerns about the lack of diversity in the CRA industry.[107]

198. The responses to the Call for Evidence also noted a number of challenges associated with the use of the investor-pays model which reflect the risks identified by the Commission. The responses noted that the risk of conflicts of interest arising is not exclusive to the issuer-pays model, it is present in any model where an interested party pays for a credit rating. They also highlighted the incentives for institutional investors to seek lower ratings to generate higher yields and bank investors to seek higher ratings to comply with capital requirements, as recognised in the Commission's 2011 Impact Assessment.

199. Some respondents expressed concern that if the CRA industry were to switch to investor-pays models for issuing credit ratings, this could undermine the objectives of the CRA Regulation to reduce reliance on credit ratings and to stimulate competition between CRAs.[108] Some respondents identified that taking credit ratings out of the public domain and requiring investors to pay for them could increase reliance on these ratings[109] rather than encouraging investors to carry out their own due diligence. Furthermore, one respondent noted that the network effects present in the industry[110] could result in investors subscribing only to the largest CRAs operating globally because of the wider coverage of their credit ratings. This would undermine efforts to stimulate competition between CRAs and promote the use of smaller CRAs.[111]

200. The investor-pays model may also reduce the size of the markets for certain instruments, which would hinder the objective of promoting a Capital Markets Union in the EU.[112] Responses to the Call for Evidence gave several reasons for this. Firstly,

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[105] As set out in Commission's Impact Assessment referred to in footnote 30 above at pages 79 and 144-145.
[106] As noted in paragraph 191 above.
[107] Investor response to question 15 of the Call for Evidence.
[108] Issuer responses to question 12 of the Call for Evidence.
[109] Issuer response to question 12 of the Call for Evidence.
[110] as explained in Section 3 above.
[111] Investor response to question 12 of the Call for Evidence.
[112] CRA response to question 12 of the Call for Evidence.

it would reduce the coverage of issuers and entities rated, especially of sub-investment grade and small and medium-sized issuers and entities rated, as investors might not be willing to pay for these ratings otherwise. Secondly, the increased investment costs associated with having to pay fees for individual credit ratings in addition to the fees charged for reports and access to ratings databases may make investments through EU funds less attractive to investors than investment through funds in jurisdictions where investor-pays models were not mandated.

201. In its 2011 Impact Assessment, the Commission also considered requiring the use of a trading venue-pays model or a model whereby CRAs would be allocated to issuers by an independent board. The first of these options was not considered feasible, as it raised concerns that it could drive trade away from organised trading venues.[113] The second option, which was noted to be similar to the Franken Amendment passed in the United States of America (US) as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act,[114] was also not considered desirable, *inter alia* as the random allocation of CRAs to issuers would not be likely to incentivise the production of high quality credit ratings at reasonable prices.[115]

202. Some respondents to the Call for Evidence referred to other alternative models in their responses such as public utility models funded by governments or the government-as-hiring agent model. It was recognised that government involvement in the allocation of issuers to CRAs could segment markets along national lines[116] and could potentially increase conflicts of interests within the industry, in particular for the issue of sovereign and sub-sovereign ratings, state-owned and state-controlled enterprises, major local banks, companies and employers and transactions deemed critical for political and economic development. State involvement raises a number of concerns about moral hazard which reflect the emphasis placed on the importance of independence by ESMA in its Technical Advice on the appropriateness of the development of a EU creditworthiness assessment of sovereign debt.[117]

203. ESMA is aware that a number of other non-profit models are currently being promoted as a means of improving the independence and transparency of ratings by removing any link to payment by stakeholders. Notable examples include the Credit Research Initiative launched by the Risk Management Institute of the University of Singapore in 2009[118] and the idea of establishing an International Credit Rating Agency (INCRA) as a non-profit organisation, which has been promoted by the Bertelsmann Foundation since 2012.[119]

204. In its 2011 Impact Assessment, the Commission ultimately recognised that all potential remuneration models create scope for conflicts of interests to arise which need to be managed. It reflected this by not mandating the use of any one particular

[113] Impact Assessment referred to in footnote 30 above at page 50.
[114] Available at https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf , last accessed 02.09.2015.
[115] These concerns were echoed in the US Securities and Exchange Commission (SEC)'s 2012 report to Congress available at: https://www.sec.gov/news/studies/2012/assigned-credit-ratings-study.pdf., last accessed 26.08.2015. Indeed, the Franken Amendment has not been implemented by the SEC to date. See Securities and Exchange Commission Release No. 34-72936; File No. S7-18-11 Final rules of 14 October 2014, available at: https://www.sec.gov/rules/final/2014/34-72936.pdf, last accessed 26.08.2015.
[116] CRA response to question 12 of the Call for Evidence.
[117] ESMA/2014/850rev, Technical Advice in accordance with Article 39(b0 2 of the CRA Regulation regarding the appropriateness of the development of a European creditworthiness assessment for sovereign debt, 17 September 2014, available at: https://www.esma.europa.eu/system/files/2014-850rev_technical_advice_on_article_39b2_cra3_revised.pdf, last accessed 26.08.2015.
[118] http://rmicri.org/, last accessed 26.08.2015.
[119] http://www.bfna.org/page/incra-the-first-international-non-profit-credit-rating-agency-for-sovereign-risk, last accessed 26.08.2015.

business model in the CRA Regulation. These conclusions are supported by academic studies[120] and reflect the experiences of the SEC in the United States of America.[121]

205. The responses to the Call for Evidence also support these conclusions. One response referred to the results of a June 2014 survey carried out by the CFA institute.[122] This survey showed that nearly 60% of respondents operating in the EMEA region agreed that all CRA business models contain conflicts of interest and that market participants should be free to decide which models work best for them in practice.

206. This is echoed by a number of responses to the Call for Evidence, which take the view that the markets for credit ratings are diverse enough to accommodate more than one business model and that it is not appropriate for regulators to prescribe the use of a particular model or to favour the use of one business model over another.[123]

4.3 Experience of provisions relating to conflicts of interest

207. In order to report on the effectiveness of the conflicts of interest provisions of the CRA Regulation, ESMA has drawn on supervisory experience gained through the registration process and during its on-going supervision of CRAs as well as the responses received to the Call for Evidence.

208. 31 CRAs (of which 16 were part of groups) were registered before ESMA became the direct supervisor of CRAs in 2011.[124] Prior to this, a number of colleges composed of NCAs reviewed CRAs' applications for registration, with CESR (and then ESMA) acting as an observer.[125] In order to be registered, a number of CRAs needed to strengthen their standards of internal control, management of conflicts of interest and policies and procedures. For example, a number of CRAs needed to strengthen the governance and policies supporting the rating process and the Chinese walls in place between their credit rating and commercial staff. A number of CRAs also had to establish an internal review function and establish policies and procedures setting out the role of this function.

209. Since ESMA became exclusively responsible for the supervision of CRAs in the EU in July 2011, it has undertaken a number of supervisory investigations which have, amongst other topics, addressed conflicts of interest in CRAs. These investigations included an initial review of the sector, investigations into sovereign, structured finance, and banking ratings as well as a number of individual investigations. ESMA has performed its role as direct supervisor not only through active supervision of CRAs and feedback to CRAs, but also by issuing guidance[126]

[120] For example, *Does it matter who pays for bond ratings? Historical evidence*, John (Xuefeng) Jiang and, Mary Harris Stanford, YuanXie; *Do Bond Issuers Shop for Favourable Credit Ratings?* Mathias Kronlund; *Rating Alignment, Rating Shopping and Reputation of Credit, Rating Agencies: Evidence from the Subprime Crisis*, Croce, Lugo, Faff; *Rating Shopping or Catering? An Examination of the Response to Competitive Pressure for CDO Credit Ratings*, Griffin, Nickerson, Tang.

[121] See for example the SEC's 2012 report to the US Congress available at: https://www.sec.gov/news/studies/2012/assigned-credit-ratings-study.pdf, last accessed 26.08.2015.

[122] http://www.cfainstitute.org/Survey/credit_rating_agency_survey_report.pdf, last accessed 17.07.2015.

[123] CRA responses to question 2, 7 and 8 of the Call for Evidence.

[124] As explained in Section 3 above.

[125] The registration process under Regulation 1060/2009 referred to in footnote 2 above was set out in Articles 14 to 20.

[126] ESMA 2015/609 Guidelines on periodic information to be submitted to ESMA by Credit Rating Agencies, 23 March 2015 available at http://www.esma.europa.eu/system/files/2015-609.pdf, last accessed 26.08.2015, ESMA 2013/720 Guidelines and Recommendations on the Scope of the CRA Regulation

and Q&As[127] clarifying ESMA's expectations of how CRAs should apply the CRA Regulation.

210. According to comments and observations provided by users of credit ratings and CRAs through the Call for Evidence, changes in user behaviour may not only reflect the impact of measures brought about solely from the CRA Regulation. For example, respondents referred to the impact of other regulatory measures regarding the use of credit ratings and the credit risk analysis performed by users of credit ratings which were implemented at the same time as the CRA Regulation entered into force, such as measures to reduce reliance on credit ratings and measures brought about through the Alternative Investment Fund Managers Directive[128] and the Directive relating to Undertakings for the Collective Investment in Transferable Securities.[129]

211. The following subsections consider the implementation of some of the key requirements set out in Articles 6-8 of the CRA Regulation and the related requirements of Annex I of the CRA Regulation.

4.3.1 Operation and conduct of credit rating agencies

212. Article 6 sets out a number of broad requirements for the operation and conduct of CRAs. It also applies to a wide range of individuals who could potentially influence a credit rating, including shareholders, managers, rating analysts and employees or any other natural person whose services are placed at the disposal or under the control of the CRA, or any person directly or indirectly linked to it by control.

213. This requirement and the related requirements of Section A and B of Annex I of the Regulation, has resulted in significant improvements in the corporate governance of CRAs. The breadth of these requirements has been helpful to ESMA, both through the registration process and its day-to-day supervision of CRAs, given the variety of processes and structures used by the CRAs registered in the EU.

214. In particular, ESMA notes that Article 6(1) requires CRAs to *'take all necessary steps to ensure that the issuing of a credit rating or a rating outlook is not affected by any existing or potential conflicts of interest or business relationship involving the credit rating issuing the credit rating or the rating outlook'*. This requirement has given ESMA the flexibility to tailor its supervision to the risks inherent to each CRA and their particular conflicts of interests, rather than to adopt a tick-box approach.

215. As well as setting up a supervisory regime based on the CRA Regulation, ESMA has taken enforcement action to ensure the implementation of the provisions of the Regulation relating to conflicts of interest. For example, ESMA took action against S&P for failure to meet its obligations under point 4 and point 10 of Section A of

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http://www.esma.europa.eu/system/files/2013-720_en.pdf, ESMA 2011/139 Guidelines on the application of the endorsement regime under Article 4 (3) of the Credit Rating Agencies Regulation No 1060/2009, 11 May 2011, available at http://www.esma.europa.eu/system/files/ESMA_2011_139.pdf, last accessed 26.08.2015.

[127] ESMA 2013/1935 Q& A on the implementation of the CRA Regulation, 17 December 2013, available at http://www.esma.europa.eu/system/files/2013-1935.pdf, last accessed 26.08.2015.

[128] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 OJ L 174, 1.7.2011, pages 1–73 available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32011L0061&from=EN, last accessed 26.08.2015.

[129] Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions, OJ L 257, 28.8.2014, pages 186–213 available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0091&from=EN, last accessed 26.08.2015.

Annex I of the Regulation which require the establishment of sound administrative and accounting procedures, internal control mechanisms, effective procedures for risk assessment and monitoring and effective control and safeguard arrangements for information processing systems.[130] ESMA has also taken enforcement action against DBRS for committing infringements relating to Article 6(2) and points 3, 4 and 6 of Section A of Annex I of the CRA Regulation regarding the establishment of adequate policies and procedures and the role of the compliance function.[131]

216. While ESMA has found that the drafting of Article 6 has given it an appropriate amount of flexibility to allow it develop its supervisory approach, one general issue encountered by ESMA in the supervision of CRAs has been the lack of clarity surrounding certain terms used in the CRA Regulation. For example, the CRA Regulation puts in place a number of requirements, including the implementation of *'sound internal control mechanisms'*[132] and *'effective procedures for risk assessment'* which are not defined.[133] It also requires *'the effectiveness of the internal quality control system'* to be monitored[134] without providing any further definition.

217. As these requirements can have wide ranging implications for the internal controls and monitoring to be carried out by the management and boards of CRAs, clarifying the terminology used would set clearer behavioural benchmarks and would help increase ESMA's supervisory effectiveness. This could be achieved by aligning the definitions used in the CRA Regulation with standards and frameworks commonly used in the internal control and audit sector.

4.3.2 Credit rating agencies' governance and compliance and review functions

218. Article 6(2) requires compliance with the extensive requirements set out in Section A and B of Annex I regarding the governance of CRAs and their compliance and review functions.

4.3.2.1 Administrative and Supervisory Boards

219. A key feature of the CRA Regulation has been the requirement for CRAs to put in place an administrative or supervisory board. This required significant changes to CRAs' corporate governance structures across the industry during the registration process.[135] By way of example, for some larger CRAs, Article 6 resulted in the establishment of administrative or supervisory boards at the EU subsidiary level for the first time. This is beneficial to ESMA as it gives it greater oversight over CRAs' strategy and the management of CRAs than would otherwise have been possible.

220. The implementation of the CRA Regulation has also resulted in the appointment of independent non-executive directors (INEDs) for the first time in several CRAs. The provisions of Annex I Section A require CRAs to appoint INEDs with sufficient expertise in financial services. In addition, on registration, CRAs are required to demonstrate that all of their senior management, including their INEDs, are of good

[130] ESMA/2015/544, Decision of the Board of Supervisors of 20 May 2014 available at https://www.esma.europa.eu/system/files/2014-544_-_decision_supervisory_measure_articles_23e_and_24_of_regulation_1060-2009.pdf, last accessed 26.08.2015.
[131] ESMA/2015/1048, Decision of the Board of Supervisors of 24 June 2015 available at: http://www.esma.europa.eu/system/files/2015-1048.pdf, last accessed 26.08.2015.
[132] Point 4 of Section A of Annex I of the CRA Regulation.
[133] Point 4 of Section A of Annex I of the Regulation.
[134] Point 2(b) of Section A of Annex I of the Regulation.
[135] Point 1 of Section A of Annex I of the Regulation.

repute.[136] INEDs have specific tasks in relation to the CRA including monitoring the development of credit rating policy and methodologies; ensuring the effectiveness of internal control systems; ensuring the effectiveness of measures and procedures to ensure conflicts of interest are identified, eliminated, managed and disclosed; as well as playing an important role in the compliance and governance process.[137]

221. ESMA has found that the inclusion of these provisions has been helpful in its supervision of CRAs. The specific tasks that the CRA Regulation requires INEDs to perform helps to ensure their engagement and accountability. ESMA identified in its March 2012 report on the supervision of CRAs[138] that some CRAs needed to improve their internal control functions and the roles and tasks of their INEDs to enhance their effectiveness. Through this review and its subsequent follow up work, ESMA has encouraged INEDs to continue developing their roles and their involvement in CRAs' activities as well as their interactions with the internal control function.[139]

222. ESMA has sought to build relationships with INEDs in order to help see CRAs' internal controls from a different perspective. INEDs play a valuable role in the risk management of CRAs and ESMA has found their insights useful in supervising CRAs. ESMA holds regular meetings with INEDs through the supervisory process to ensure that the relevant provisions of the CRA Regulation are being applied by CRAs in practice.

223. Although ESMA can take action against CRAs for failing to appoint INEDs with sufficient expertise,[140] or in cases where INEDs do not fulfil their monitoring and reporting functions,[141] ESMA may benefit from having the ability to be more proactive in ensuring the appointment of appropriate INEDs, for example by preventing the appointment of or requiring the removal of INEDs and requiring the INEDs that CRAs wish to appoint after registration to demonstrate certain minimum standards of knowledge or good repute. This would allow ESMA to ensure consistently high levels of governance across CRAs.

224. Whilst ESMA would benefit from greater powers regarding INEDs to ensure their effectiveness, ESMA is seeking to achieve this in the first instance by clarifying the current regulatory requirements. For example, ESMA will host a roundtable for INEDs in November 2015 which will provide a forum to discuss the role of INEDs under the CRA Regulation and the challenges they face. This roundtable and subsequent follow up work should also help to raise awareness amongst CRAs of INEDs' key tasks.

4.3.2.2 Compliance Function

225. Annex I Section A point 6 of the CRA Regulation sets out requirements for the establishment of a compliance function, its role and its independence. These requirements have helped to ensure that CRAs have compliance functions in place that can monitor the application of the CRA Regulation within their organisation. It has also ensured that ESMA can have a constructive supervisory dialogue with a

[136] See Commission Delegated Regulation 449/2012 of 21 March 2012, OJ L 140/32 of 30.5.2012 referred to in footnote 31 above at Article 15.
[137] See Annex I Section A points 2(6) a-d of the CRA Regulation,
[138] ESMA2012/207 ESMA's Report on the Supervision of Credit Rating Agencies, 22 March 2012 available at: http://www.esma.europa.eu/system/files/2012-207.pdf, last accessed 28.08.2015.
[139] *Ibid*, at page 10**.**
[140] In accordance with Annex III, part I point 8 of the CRA Regulation.
[141] Annex III, part I points 9-10 of the CRA Regulation.

specialist function. These requirements complement the detailed instructions for ratings analytical staff and establish a risk and control environment for the day-to-day operation of CRAs which provides for active risk management and periodic reporting. ESMA has already enforced these requirements by taking action against a CRA where it failed to meet the requirements of an effective compliance function, in particular the need to have in place a formal work plan, to carry out risk assessment activities and to keep sufficient records.[142]

226. The CRA Regulation does not elaborate further on other monitoring and oversight functions typically found in commercial organisations. For example, there is no further articulation of the usual tasks and responsibilities of a risk management function. The CRA Regulation also does not contain any requirements for an internal audit function, a function which would provide a systematic approach to the evaluation and identification of measures to improve the effectiveness of risk management and governance processes. As a consequence, there is a risk of blurring the role of the compliance function with that of the risk management or internal audit function.

227. A reflection of internationally used risk management and internal control frameworks and the best practices for risk management typically used by both large and small companies, such as the three lines of defence model, would align the CRA Regulation with current practices and help to ensure the full effectiveness of CRAs' internal controls.

4.3.2.3 Review Function

228. Annex I Section A point 9 of the CRA Regulation establishes a review function responsible for *'periodically reviewing its methodologies, models and key rating assumptions, such as mathematical or correlation assumptions, and any significant changes or modifications thereto as well as the appropriateness of those methodologies, models and key rating assumptions where they are used or intended to be used for the assessment of new financial instrument'*. It further provides that the review function *'shall be independent of the business lines which are responsible for credit rating activities and report to the members of the administrative or supervisory board'*.

229. A number of CRAs did not have an independent review function (IRF) in place prior to registration and some CRAs had to restructure their organisations to meet the requirement. ESMA has provided direction to CRAs on the application of this requirement, mainly by highlighting that CRAs should aim not only for formal structural separation but also for effective separation in practice. The majority of ESMA's supervisory actions in relation to the IRF have been based on strengthening the independence between the IRF and rating business.

230. For example, ESMA's 2012 Sovereign Ratings Investigation found that in one CRA the internal review function was involved in credit rating activities in a way which could call its independence into question as it was also participating in all stages of the decision making process for the issue of sovereign ratings. In at least one CRA a member of the review function had had specific analytical responsibilities

[142] ESMA/2015/1048, Decision of the Board of Supervisors of 24 June 2015, available at http://www.esma.europa.eu/system/files/2015-1048.pdf, last accessed 28.08.2015.

for a sovereign rating for over a year, but this had not been identified by any of the CRA's internal controls.[143]

231. In addition, during its Structured Finance Investigation[144] ESMA found that, in one or more CRAs, the involvement of the analytical function in the review process, including the responsibilities assigned, the type of activities performed and approval powers granted, had the potential to undermine the review function's independence and did not ensure that the periodic review of methodologies, models and key rating assumptions were conducted independently from credit rating activities.

232. For instance, ESMA found that in one or more CRAs the analytical staff who were applying the methodologies, models and key rating assumptions as part of the credit rating analysis, were also responsible for performing key review activities, such as model testing or drafting annual review documents, while the review function remained responsible for checking the outcome of activities performed by the analytical function. Furthermore, in some CRAs, members of the analytical team had been given voting rights in the committees which were approving or validating the models used in the rating process.[145]

233. There are some parts of this requirement where further clarity, for example regarding the role and responsibilities of the IRF, including the IRF's independence from credit rating activities, would assist ESMA in its supervision as noted in ESMA's Technical Advice in accordance with Article 39(b)2 of the CRA Regulation regarding the appropriateness of the development of a European credit worthiness assessment for sovereign debt.[146]

234. Clarity as to how ESMA and CRAs should interpret the methodological framework would be beneficial for CRAs for example as regards the extent to which documents that support methodologies, such as criteria, special comments and guidance for analysts, should be included within the review processes of the IRF. ESMA notes that the 2015 IOSCO code defines rating methodology as *'the procedure by which a CRA determines credit ratings, including the information that must be considered or analysed to determine a credit rating and the analytical framework used to determine the credit rating, including, as applicable, the models, financial metrics, assumptions, criteria, or other quantitative or qualitative factors to be used to determine the credit rating*.'[147] A clearer definition of rating methodology in the CRA Regulation would also allow ESMA to supervise the requirement in Article 8 on methodologies more effectively.[148]

[143] ESMA/2013/1775 Sovereign ratings investigation, 2 December 2013 at page 8, available at: https://www.esma.europa.eu/system/files/2013-1780_esma_identifies_deficiencies_in_cras_sovereign_ratings_processes.pdf last accessed 11.08.2015.
[144] ESMA 2015/1524, ESMA's investigation into Structured Finance Ratings, 16 December 2014 available at http://www.esma.europa.eu/system/files/esma-2014-1524_cra_public_report_on_sf__investigation.pdf, last accessed 11.08.2015.
[145] Sovereign ratings investigation referred to in footnote 129 above at page 17.
[146] ESMA 2014/850rev Technical Advice in accordance with Article 39(b)2 of the CRA Regulation regarding the appropriateness of the development of a European credit worthiness assessment for sovereign debt, at page 12, available at http://www.esma.europa.eu/content/Technical-Advice-accordance-Article-39b-2-CRA-Regulation, last accessed 28.08.2015.
[147] IOSCO Code of Conduct Fundamentals for Credit Rating Agencies Final Report 2015, March 2015 available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD482.pdf, last accessed 27.08.2015.
[148] See Section 4.3.8 below.

4.3.2.4 Provision of ancillary services

235. Point 4, Section B of Annex I of the Regulation states that:

'A credit rating agency may provide services other than [the] *issue of credit ratings (ancillary services). Ancillary services are not part of credit rating activities; they comprise market forecasts, estimates of economic trends, pricing analysis and other general data analysis as well as related distribution services. A credit rating agency shall ensure that the provision of ancillary services does not present conflicts of interest with its credit rating activities and shall disclose in the final ratings reports any ancillary services provided for the rated entity or any related third party.'*

236. This definition has not been consistently applied by CRAs and a number of CRAs have queried whether certain activities should be treated as ancillary services; what constitutes advice or consultancy services; and where the line might be drawn between making assumptions in order to issue a rating and providing guidance or advice. By way of example, it is unclear whether hypothetical ratings services provided by CRAs, which may be sought by issuers considering a change to their capital structure or a merger, are included within the definition of ancillary services. ESMA will continue to consider whether guidance or Q&As would be helpful to CRAs and users of credit ratings in this regard.

4.3.3 Exemptions for smaller credit rating agencies

237. Article 6(3) of the CRA Regulation allows CRAs to apply for exemption from the requirements of points 2, 5, 6 and 9 of Section A of Annex I of the Regulation which require: at least one third of members of the administrative or supervisory board to be independent members; the establishment of a compliance function; the establishment of a review function responsible for the periodic review of its methodologies, models and key rating assumptions. A CRA may receive these exemptions if it can demonstrate that these requirements are not proportionate in view of the nature, scale and complexity of its business and the nature and range of issue of credit ratings and if it can demonstrate it has fewer than 50 employees, has implemented measures, procedures and reporting arrangements ensuring the independence of rating analysts and persons approving credit ratings, and that the size of the CRA is not determined in such a way as to avoid compliance with the requirements of the CRA Regulation. A further exemption is available from compliance with Article 7(4) of the Regulation which requires the mandatory rotation of credit rating analysts.

238. There are currently ten CRAs which are exempt from at least one of the requirements of points 2, 5, 6 and 9 of Section A of Annex I and Article 7(4) of the CRA Regulation. ESMA has generally found that the exemptions are helpful in supporting and promoting diversity in the size and scale of the CRAs registered in the EU and helping to ensure that the impact of the CRA Regulation is proportionate to CRAs of different sizes.

239. However, a key challenge in applying Article 6(3) of the CRA Regulation is that headcount is used as the only quantitative measure for granting exemptions, while the use of outsourcing, consultants, part-time employees and joint ventures with sister companies occur frequently in the industry, particularly for services such as IT and marketing.

240. Some respondents to the Call for Evidence raised concerns that the exemption requirements are insufficient as they are limited to either the size or market activities of the CRA rather than taking into account the risk a CRA may pose to the financial system. These respondents also suggested that making eligibility for exemption dependent on a 50 full time employee (FTE) headcount was a barrier to growth, as it could create cliff effects for businesses and limit their profitability once their headcount exceeds this number. These respondents did not however propose a threshold or alternative criteria for exemption.

241. The same respondents also stated that even with exemptions, the cost of compliance was disproportionately high for smaller CRAs. For example, one CRA with one exemption estimated that since registration in 2011, its compliance costs had been approximately €500,000 per annum. Another CRA with two exemptions estimated that compliance costs accounted for 10-12% of its revenues, taking into account fixed, intangible and lost opportunity costs.

242. As ESMA has received only limited data from CRAs regarding compliance costs, it cannot comment on their reasonableness at this stage. ESMA does however recognise that certain requirements of the CRA Regulation, particularly those regarding the establishment of a compliance function and the appointment of INEDs, can increase employment costs significantly. Nevertheless, ESMA's general impression is that the exemption requirements are meaningful as they seek to ensure the independence of the credit rating process.

243. However, ESMA would welcome further measures to assess exemption requirements consistently and to mitigate the cliff-effects tied to headcount. For example, additional measures linked to turnover and the payment of supervisory fees would further reflect the economic reality of some smaller CRAs. This would also reflect similar exemptions in other EU directives, such as the EU Accounting Directive 2013 which bases exemptions for small undertakings on their ability to meet two out of three criteria which are based on balance sheet size, net turnover and average number of employees during the financial year.[149]

4.3.4 Skills and experience of those involved in credit rating activities

244. Article 7 and Annex I Section C of the CRA Regulation set out a number of requirements related to the knowledge, skills and behaviour of rating analysts, its employees and any other natural person whose services are placed at its disposal or under its control and who are directly involved in credit rating activities. These requirements strengthen the separation between commercial and rating activities in Article 7(2) and Article 7(5) of the CRA Regulation.

245. In supervising Article 7(1) of the CRA Regulation, which requires staff to have appropriate knowledge and experience to carry out the duties assigned to them, ESMA has taken a number of steps. These include regularly interviewing senior staff, particularly new recruits, assessing their backgrounds and giving feedback to CRAs.

[149] Directive 2013/34/EU of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ L 182/19 of 29.6.2013 (EU Accounting Directive 2013), available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0034&from=EN, last accessed 27.08.2015.

Through CRAs' periodic reporting, ESMA monitors key senior management positions and turnover rates to highlight risks in CRA staff resourcing.

246. ESMA finds that Article 7(2) of the CRA Regulation has been effective in reinforcing the segregation of CRAs' commercial and credit rating activities, including the negotiations regarding fees, at the most senior levels of management and governance. Some CRAs needed to adapt their corporate structure to reflect these requirements by separating out commercial and rating activities prior to registration. For example, ESMA's 2013 investigation into the sovereign rating process found that in one CRA, one or more board directors with commercial responsibilities continued to be involved in the rating process, discussing with senior managers of the sovereign team about the appropriate rating action to be taken, as well as participating in the rating process by voting in the rating committee.[150]

4.3.5 Rules for analysts and others directly involved in credit rating activities

247. Annex I Section C of the CRA Regulation imposes constraints on the buying and selling of financial instruments of any rated entity within their primary analytical responsibility. Analysts are also not able to participate in or otherwise influence the determination of a credit rating or rating outlook where there may be a perceived conflict of interest, or has had a recent employment, business or other relationship with the rated entity.

248. The confidentiality of information within the rating process is a critical issue which is applicable to anyone involved in the rating process and an essential factor in maintaining the integrity of the rating process. CRAs should take the necessary steps to ensure that such information is adequately protected and that advance information is not disclosed or misused by unauthorised third parties.

249. Following ESMA's first supervisory activities, it appears that non-analytical staff, such as those working in communications, research and IT, as well as assistants and members of the review function may have access to confidential information about future rating actions in the course of their work. Currently these staff members may be excluded from the confidentiality requirements of Section C of Annex I of the CRA Regulation as they are not staff *'directly involved in credit rating activities'*.[151] ESMA will consider whether it can provide guidance as to the staff members which fall within this category, through future guidelines or Q&As.

250. ESMA notes a practical difficulty for CRAs in adhering to the requirement set out in Point 7 of Section C of Annex I of the CRA Regulation that an employee of a CRA may not take up a key management position of a rated entity or related third party within six months of the issuing of a credit rating or rating outlook. As there is no definition of *'key management position'* which ESMA and CRAs can apply in ensuring compliance with this requirement, ESMA's ability to supervise and ensure

[150] Sovereign ratings investigation referred to in footnote 129 above at page 7.

[151] Point 1 of Section C states: Rating analysts, employees of the credit rating agency as well as any other natural person whose services are placed at the disposal or under the control of the credit rating agency **and who is directly involved in credit rating**, and persons closely associated with them within the meaning of Article 1(2) of Directive 2004/72/EC, shall not buy or sell or engage in any transaction in any financial instrument issued, guaranteed, or otherwise supported by any rated entity within their area of primary analytical responsibility other than holdings in diversified collective investment schemes, including managed funds such as pension funds or life insurance' (emphasis added). This refers to Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions, OJ L 162, 30.4 2004, p 70.

consistent application by CRAs is limited. ESMA will consider whether issuing guidance or Q&As would be helpful in the application of this requirement.

4.3.6 Gradual rotation of credit rating analysts

251. Article 7(4) of the CRA Regulation requires that CRAs establish an appropriate gradual rotation mechanism with regard to the ratings analysts and persons approving credit ratings defined in Section C of Annex I. Point 8 of Article 7(4) provides further details of how this should be applied for lead analysts, rating analysts and persons approving credit ratings.

252. Given that this requirement has been in place for less than 5 years, it is difficult to report based on supervisory experience on the practical application of the process by CRAs, or the effectiveness of the requirement as a means to reduce conflicts of interests.

253. ESMA notes that a number of CRAs applied for exemption from this requirement after registration, perhaps after concluding that they did not have sufficient resources to ensure gradual rotation in practice. ESMA will typically grant this exemption if a CRA can provide evidence of controls regarding analytical independence, including, for example, the use of rating committees. Some respondents to the Call for Evidence felt that this requirement, similarly to mandatory rotation, could be overly burdensome and expensive to implement, both from the perspective of the CRA and the issuer.[152]

254. ESMA notes that mandatory rotation of analysts is a measure typically used in a number of sectors, including audit, where an arm's length relationship needs to be maintained. For example, in the UK, the Auditing Practices Board Ethical Standard 3 (Revised) on *'Long Association with the Audit Engagement'* puts in place a number of safeguards, including that the audit engagement partner should only be involved in the audit of a particular entity for a maximum of five years, following which he cannot be involved in the audit process for that entity again for the next five years.[153]

4.3.7 Compensation and performance of employees

255. Article 7(5) states that the compensation and performance of employees involved in producing credit rating activities or rating outlooks, as well as persons approving credit ratings, shall not be contingent on the amount of revenue that the CRA derives from the rated entities or related third parties. This is an important means of removing any shared incentives between commercial and credit rating activities and helping to align credit rating activity measures with rating performance.

256. Given that the revenues generated by a company affect its share price, there is a link between revenues and share-based compensation. ESMA notes that during the registration of CRAs, share ownership was permitted as part of the compensation package for staff in some of the larger CRAs. This is because the share ownership was a small percentage of the CRA's shares and it was viewed as creating a minimal and manageable risk of conflicts of interest. ESMA notes that this has created a

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[152] See the responses to questions regarding mandatory rotation under Article 6b of the CRA Regulation presented in Section 6.1 below.

[153] Financial Reporting Council, Auditing Practices Board, revised Ethical Standard 3: Long Association with the Audit Engagement, October 2009 at page 7, available at: https://www.frc.org.uk/Our-Work/Publications/APB/ES-3-(Revised)-Long-Association-with-the-Audit-Eng.pdf, last accessed 27.08.2015.

precedent, which if applied to smaller CRAs could create a more significant conflict of interests for analysts because the effective share ownership would be much larger. ESMA has monitored this risk through its ongoing supervision and through the registration process. ESMA has not observed any examples of situations to date where employee share ownership has influenced a rating outcome.

4.3.8 Methodologies, models and key assumptions

257. Article 8 sets out a number of requirements related to the disclosure, processes and validation of methodologies, models and key credit rating assumptions. It requires CRAs to use rating methodologies that are rigorous, systematic, continuous and subject to validation, based on historical experience including back-testing. These measures are important for users of ratings in helping them to assess the quality of methodologies and the independence of credit ratings issued by CRAs.

258. ESMA is required to examine the validation performed by CRAs of their methodologies and models under Article 22 of the Regulation. Article 23 of the CRA Regulation makes it clear that neither ESMA, nor the Commission, nor the public authorities of a Member State shall interfere with the content of credit ratings or methodologies.

259. Although the investors who responded to the Call for Evidence confirmed that they conduct their own due diligence rather than relying exclusively on credit ratings,[154] ESMA is concerned that some market participants may perhaps be less vigilant in reviewing CRAs' disclosures than they would otherwise be, as they understand that ESMA actively monitors these.[155]

260. ESMA can examine whether CRAs' methodologies are rigorous, systematic, continuous and subject to validation based on historical experience, including back testing. However, although ESMA has a role in examining compliance with Article 8(3) of the CRA Regulation, it does not, and should not have a role in the approval of methodologies. ESMA is currently conducting an investigation which reviews the validation processes and statistical methods used by some of the larger CRAs. ESMA will reiterate that it does not and should not have any role in the approval of methodologies through any publications resulting from this investigation.

4.3.9 Advance notification of intended publication of credit ratings or rating outlooks

261. Annex I Section D point 3 of the CRA Regulation requires CRAs to inform the rated entity or the issuer about the credit rating or rating outlook that they intend to publish at least one working day prior to publication in order to allow them to check for factual errors.

262. This provision only entered into force in June 2013 as part of the most recent amendments to the CRA Regulation and so it is difficult to assess its effectiveness at this time. ESMA is keen to raise awareness of the need to comply with these new disclosure requirements in general, and has sought to do through its interactions with CRAs as well as through the process of conducting thematic reviews, such as the

[154] Investor responses to questions 5-9 of the Call for Evidence.
[155] These concerns have arisen through interviews with stakeholder groups. See also Issuer response to question 17 of the Call for Evidence.

review of the practices of 18 small and medium-sized CRAs carried out in 2014 as highlighted in ESMA's 2014 annual report and work plan for the supervision of credit rating agencies and trade repositories (2014 Annual Report).[156]

263. During this review, ESMA found that some CRAs allowed the ratings review process by issuers to be carried out over a period of several weeks. The risk of confidential information being leaked and the risk of the issuer influencing the decision of the CRA increases with the length of time between ratings decisions being made, sent to the issuer for the checking of factual errors and the ultimate publication of the credit rating. ESMA encourages CRAs to reduce the length of the factual review process as much as possible in order to minimise these risks. Indeed, ESMA understands that following its review, a number of CRAs reduced the length of time between ratings decisions being made and published to three working days.

264. ESMA has also raised awareness amongst CRAs of the need to be able to demonstrate their compliance with the requirements of the CRA Regulation regarding conflicts of interest through its 2014 Annual Report. ESMA noted in this report that two CRAs were unsuccessful in their applications for registration in 2014 as they were not able to demonstrate their compliance with the requirements of the CRA Regulation in some key areas regarding internal controls and the absence of conflicts of interest, such as Annex I Section D point 3. The applicants could not demonstrate compliance with a number of these points as their policies and procedures did not describe the different steps of the process to be followed in sufficient detail or did not clearly allocate roles and responsibilities for the tasks outlined.

4.4 Effectiveness of provisions in mitigating conflicts of interests

265. Articles 6 and 7 of the CRA Regulation have provided an effective basis for ESMA to supervise the management of conflicts of interest inherent to both the issuer-pays and investor-pays models of CRAs. These provisions already appear to have had a positive impact on the governance and operation of CRAs overall.

266. In particular, ESMA finds that the provisions of the CRA Regulation are flexible enough to allow it to take action to address concerns regarding conflicts of interest, including those relating to key governance and internal control functions such as compliance and the IRF. ESMA has clarified aspects of the CRA Regulation through guidelines and Q&As which support the consistent application of the Regulation by all CRAs as well as through firm-level supervisory feedback.

267. ESMA's supervision of CRAs could however be even more effective if it could clarify some of the key terms used in Articles 6 and 7 of the CRA Regulation and in Annex I, such *'ancillary services'*, *'internal controls'* and the role of the IRF. By clarifying these terms, ESMA could provide greater certainty to registered CRAs as to the requirements they have to comply with. In addition, aligning the internal control arrangements provided for in the CRA Regulation with a standard risk framework which is proportionate to the scale and complexity of a CRA, such as a three lines of

[156] ESMA 2015/280, ESMA Supervision of Credit Rating Agencies and Trade Repositories, Annual Report 2014 and Work Plan, 16 February 2015, at pages 18 and 19 available at: http://www.esma.europa.eu/system/files/esma-2015-280_cra_and_tr_annual_report_2014_and_supervisory_work_programme_2015.pdf, last accessed 27.08.2015.

defence model, would strengthen CRAs' internal controls, particularly the management of operational risks, such as IT risk.

268. INEDs play a valuable role in the risk management of CRAs and ESMA has found their insights useful in supervising CRAs. ESMA may benefit from having the ability to be more proactive in ensuring the appointment of appropriate INEDs as this would it ESMA to ensure consistently high levels of governance across CRAs. However, ESMA is seeking to help ensure the effectiveness of INEDs in the first instance by clarifying the current regulatory requirements through its on-going supervision.

269. Broadening the measures that ESMA could use in assessing whether a CRA meets the criteria for exemption set out in the CRA Regulation would reflect the approach adopted in other EU legislation and address the concerns that an exemption linked to a 50 FTE requirement can be hard to measure and could create a cliff effect to growth for smaller CRAs.

270. ESMA will continue to work with market participants to ensure that its supervisory role is fully understood, particularly in regard to Article 23 of the Regulation, that in carrying out its duties, ESMA shall not interfere with the content of credit ratings or methodologies.

5 Impact of CRA Regulation on competition between credit rating agencies

5.1 Objectives of provisions

271. The way in which firms compete depends on the structure of the industry and the different geographic markets in which they operate, such as the legal and regulatory frameworks in place. These frameworks in turn influence firms' costs structures and their behaviour as well as the behaviour of their customers.[157]

272. Competition between firms operating in competitive markets usually results in beneficial outcomes, such as greater choice and innovation, higher quality and lower prices. An efficient firm will aim to set its prices so that it charges as much as the markets will bear for the products it can produce the most cheaply. Any excess quality or cost is competed away as firms aim to reach these efficient levels. Although this strategy is efficient in economic terms, it may result in a race to the bottom, which may harm consumers unless minimum standards of quality are respected. These minimum standards may be provided for by law or by industry codes of practice.

273. In the CRA industry, the IOSCO Code[158] provided best practices for CRAs but these were not binding in all jurisdictions. The lack of minimum regulatory standards allowed CRAs to issue ratings on some new types of SFIs in the late 1990s and early 2000s, such as re-securitisations. However, the 2008 financial crisis demonstrated that the credit ratings issued on these products in some jurisdictions were not always of sufficient quality. In response to the financial crisis, the EU sought to address these concerns through the Regulation of CRAs. The effect of following key provisions which may have an impact on competition between CRAs will be presented in this Section:

- Registration.
- Enforcement and civil liability.
- Transparency through the public interface of ESMA's CEREP database, disclosures relating to SFIs and the establishment of the European Rating Platform.
- The requirement to consider appointing smaller CRAs when appointing multiple CRAs.
- ESMA oversight of fees charged by CRAs.

274. In addition, the 2013 amendments to the CRA Regulation introduced a number of measures to stimulate competition in the provision of structured finance ratings and restore trust in these markets. These can be found in Articles 6b, 8b and Art 8c of the CRA Regulation, the impact of which will be considered in Section 6 below.

275. When the EU created the European Supervisory Authorities (ESAs), ESMA was given a specific competitiveness objective. This objective is set out in Article 1(5)(d) of the ESMA Regulation which notes that ESMA contributes to the stability and

[157] See Carton and Perloff, *Modern Industrial Design*, International Edition, 4th Edition, Chapter 8 pages 246-247.
[158] The first IOSCO code of conduct for CRAs was issued in December 2004: and is available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD180.pdf, last accessed 27.08.2015. A most recent version of the code was issued in March 2015: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD482.pdf, last accessed 27.08.2015.

effectiveness of the financial system and *'shall contribute to…preventing regulatory arbitrage and promoting equal conditions of competition.'* [159]

276. ESMA seeks to apply this objective in its on-going supervision of CRAs, and in particular in ensuring the application of the 2013 amendments to the CRA Regulation which seek to increase competition between CRAs and encourage the use of smaller CRAs.[160] As the different objectives of the CRA Regulation do not always coincide in practice, ESMA seeks to strike a balance between promoting competition and increasing transparency whilst stimulating investor protection and contributing to the overall stability and effectiveness of the financial system.

5.2 Experience of provisions with a potential to impact on competition

277. This subsection considers how each of the provisions with a potential to impact on competition between CRAs have been implemented, by reference to ESMA's practical experience of the provisions and responses received to the Call for Evidence about their effect on competition overall.

5.2.1 Registration

278. As noted in Sections 3 and 4 above, the majority of CRAs were registered at national level by the NCAs. ESMA has registered 7 CRAs since it assumed responsibility for the registration of CRAs. The registration process is explained in Articles 14-20 and in Annex II of the CRA Regulation. The requirements to be met by applicants for registration are set out in further detail in the Commission Delegated Regulation regarding regulatory technical standards for the registration and certification of CRAs.[161] Registration provides visibility to CRAs as ESMA maintains a list of registered CRAs on its website. CRAs certified in accordance with the procedure set out in Article 5 of the CRA Regulation also benefit from this visibility.

279. In addition to the visibility provided by registration, some of the CRAs who responded to the Call for Evidence suggested that it would help them to demonstrate the quality of the products and services that they offer if they could advertise that they were ESMA registered.[162] It appears that registration may already have this effect to a certain extent, as a number of respondents to the Call for Evidence referred to registration and compliance with the CRA Regulation as criteria they would take into account in their choice of CRA[163] and one association of investors noted that ESMA registration creates a presumption of expertise.[164]

280. However, in this regard ESMA notes that Article 10(6) of the CRA Regulation states that *'a credit rating agency shall not use the name of ESMA or any competent authority in such a way that would indicate or suggest endorsement or approval by ESMA or any competent authority of the credit ratings or any credit rating activities of the credit rating agency'*.

[159] This competitiveness objective does not include the investigation and enforcement of the competition provisions set out in Title VII of the Treaty on the Functioning of the European Union, which is the responsibility of the European Commission.
[160] Recital 11 of Regulation 462/2013 of 21 May 2013, OJ L146 of 31.5.2013 referred to in footnote 2 above.
[161] Commission Delegated Regulation 449/2012 of 21 March 2012, OJ L 140/32 of 30.5.2012 referred to in footnote 31 above.
[162] CRA responses to questions 23 and 24 of the Call for Evidence.
[163] Issuer responses to questions 3-5 of the Call for Evidence.
[164] Investor response to question 19 of the Call for Evidence.

5.2.2 Enforcement and civil liability

281. Providing ESMA with enforcement powers and the power to impose fines on CRAs for breaches of the Regulation helps to increase CRAs' accountability and provides information to market participants about cases where CRAs have not been compliant with the CRA Regulation. In this way, its enforcement work helps ESMA to highlight the behavioural standards that it expects from all CRAs.

282. In addition, the 2013 amendments to the CRA Regulation introduced provisions regarding civil liability of CRAs. Article 35(a) provides that issuers and investors can claim damages in some cases where a CRA has committed certain infringements with intention or gross negligence. These infringements are listed in Annex III of the CRA Regulation.[165] It is too soon to tell if such private actions will be a natural complement to enforcement action by ESMA.[166]

283. It is not yet possible to assess the impact of these provisions as only two enforcement cases have been successfully concluded at the date of publication of this Technical Advice and the provisions on civil liability are still being implemented in the Member States.

284. However, ESMA's experience to date suggests that the impact of its enforcement powers would be increased if all the requirements of the CRA Regulation were to have a corresponding infringement[167] and if ESMA's ability to impose fines could be tailored to have a more dissuasive effect, by better reflecting the turnover of the CRAs operating in the EU.[168]

285. As a general principle, penalties for infringements of EU law must be effective, proportionate and dissuasive.[169] When the 2011 amendments to the CRA Regulation were being negotiated, it was agreed that ESMA would have the power to impose fines and periodic penalties for breaches of the CRA Regulation by decision of ESMA's Board of Supervisors. This is reflected in Title IV of the CRA Regulation.

286. ESMA's ability to impose fines is subject to strict limits in accordance with Article 36a of the CRA Regulation which makes the imposition of a fine dependent on a finding by ESMA's Board of Supervisors that the infringement has been committed intentionally or negligently. In such cases, Article 36a then sets out the minimum and maximum levels of the basic amount of the fine to be imposed for specific groups of infringements, which may be adjusted either upwards or downwards to take into account the aggravating and mitigating factors set out in Annex IV of the CRA Regulation.

287. The basic amount of the fines to be imposed for infringements of different sections of the CRA Regulation is set out in Article 36a(2). These amounts range from

[165] Article 35(a) notes that terms such as *'intention'* or *'gross negligence'* are to be interpreted as defined in accordance with the applicable national law

[166] See the Decision of the Federal Court of Australia in the case of *ABN AMRO Bank NV v Bathurst Regional Council [2014]* FCAFC 65.

[167] For a detailed consideration of this issue with regard to the fees charged by CRAs for credit ratings and ancillary services, please see Section 5.2.4 below.

[168] ESMA has also stated that it supports a review of the level of the fines which can be imposed on Trade Repositories under Article 65(2) of Regulation 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ L201 of 27.72012 (EMIR). See ESMA 2015/1254 EMIR Review Report no.4 of 13 August 2015, available at: http://www.esma.europa.eu/system/files/esma-2015-1254_-_emir_review_report_no.4_on_other_issues.pdf, last accessed 19.08.2015.

[169] Case 68/88 *Commission* v *Greece* [1989] ECR 2965, paragraphs 23 and 24; Joined Cases 387/02,391/02 and 403/02 *Berlusconi and Others* [2005] ECR I-3641.

€10,000-€50,000 for certain record keeping infringements[170] to between €500,000 and €750,000 for infringements relating to issues including conflicts of interest and disclosures.

288. In order to ensure that fines do not have a disproportionate effect on CRAs of different sizes, Article 36a(2) also requires ESMA to take into account the turnover of the infringing CRA in the preceding business year. The article notes that the basic amount of the fine should be set at the bottom end of these limits for CRAs with an annual turnover of below €10 million, the mid-range for those with an annual turnover of between €10 million and €50 million, and at the upper end of the limit for those with an annual turnover of over €50 million. Furthermore, Article 36a(4) provides that the fine shall not exceed 20% of the annual turnover of the CRA in the preceding year.

289. ESMA's experience of imposing sanctions on CRAs is limited at this stage. From the two infringement decisions adopted to date, one resulted in the issue of a public notice, and the other resulted in the issue of a public notice and the imposition of a fine.

290. ESMA's first infringement case under the CRA Regulation resulted in the issue of a public notice regarding the conduct of Standard & Poor's Credit Market Services France SAS and Standard & Poor's Credit Market Services Europe Limited (S&P) in 2014. In this case an email alert was sent to subscribers of S&P's Global Credit Portal informing them that S&P had downgraded its unsolicited rating of France, when it had not in fact done so. ESMA did not impose a fine in this instance because it was not satisfied that the infringement was committed with intention or negligence.[171]

291. On 24 June 2015, ESMA issued a public notice[172] regarding DBRS's failure to:

- comply with the requirements to establish adequate policies and procedures and to maintain procedures and structures which specify reporting lines and allocate functions and responsibilities;[173]
- establish an effective compliance function;[174] and
- keep adequate records and audit trails of its credit rating activities.[175]

292. ESMA imposed its first fine on a CRA for failure to comply with the CRA Regulation in this case as it found that DBRS had acted negligently in respect of the record-keeping infringements. Article 36a of the CRA Regulation explains that the basic amount of the fine to be imposed for this infringement is between €50,000 and €150,000, subject to the adjustment for aggravating and mitigating factors set out in Annex IV of the CRA Regulation. In this case, the fine was reduced to €30,000 using the coefficient for mitigating factors on account of the steps taken by DBRS to remedy the infringement voluntarily.[176]

[170] Article 36a(2)(f).
[171] ESMA/2014/544, Decision of the Board of Supervisors of 20 May 2014 available at: ESMA's decision to adopt a public notice regarding a release by S&P erroneously suggesting a downgrade of the Republic of France, referred to in footnote 120 above.
[172] ESMA/2015/1048, Decision of the Board of Supervisors of 24 June 2015, referred to in footnote 121 above.
[173] In accordance with Annex I Section I points 11 and 12 of the CRA Regulation.
[174] In accordance with Annex I Section A point 5 and 6 of the CRA Regulation.
[175] In accordance with Annex I Section B point 7 of the CRA Regulation.
[176] In accordance with Annex IV part II of the CRA Regulation.

293. ESMA believes that there may be scope to refine its sanctioning powers within the confines of the case law of the Court of Justice regarding the delegation of powers by the EU institutions[177] in order to ensure that ESMA can impose sanctions which are more effective, proportionate and dissuasive.

294. From its supervisory experience, ESMA understands that there are at least 5 CRAs operating in the EU which generate revenues of under €1 million a year. At the opposite end of the scale, 3 CRAs operating in the EU are currently generating revenues in excess of €100 million a year.[178] On this basis, ESMA believes that the proportionality of the sanctioning regime would be enhanced if the turnover thresholds set out in Article 36a(4) of the CRA Regulation were amended to reflect this reality. For example, this could allow ESMA to apply the bottom end of the basic amount to those CRAs generating revenues of less than €1 million a year, the mid-range to those generating between €1 million and €40 million a year, and the upper end to CRAs with a turnover of over €40 million a year.

295. Furthermore, whilst ESMA believes that the lower limits of the basic amount of the fines set out in Article 36a(2) of the CRA Regulation should remain unchanged, ESMA recommends that the upper limits of the basic amount of the fines should be increased to five times their current level in order to reflect the important role played by high quality credit ratings in the efficient functioning of the EU's financial markets and the wider economy. Setting the upper limits at this higher level would ensure that the fines imposed have a sufficient deterrent effect relative to the turnover of the infringing CRA, given the significant revenues generated by the largest CRAs operating globally. The proportionality of the fines being imposed would still be respected as all fines would remain subject to the 20% maximum turnover threshold set out in Article 36a(4) of the CRA Regulation.

296. In ESMA's view, these amendments would enhance the sanctioning regime by ensuring that effective, proportionate and dissuasive fines can be imposed without discouraging smaller CRAs from entering the industry.

5.2.3 Measures to promote transparency

297. The CRA Regulation contains a number of measures to promote transparency which may provide further visibility to CRAs operating in different markets within the EU by allowing users to compare ratings from different CRAs. It was also hoped that some of these measures would stimulate the production of unsolicited ratings. As a CRA's reputation and experience of rating particular entities and instruments is important to market participants in their choice of CRA,[179] issuing unsolicited ratings may be a good way for new entrants and SMEs to demonstrate the quality of their credit ratings and allow them to gain the confidence of investors and issuers.[180]

5.2.3.1 CEREP

298. Credit ratings data made available to the public through the CEREP database allows market participants to examine the performance of credit ratings issued by individual CRAs. Although it does not allow users to compare credit ratings across

[177] Case 9/56 *Meroni* v *High Authority* [1957 and 1958] ECR 133.
[178] As noted in Section 3.2.6.4 above.
[179] Issuer responses to questions 3-5 of the Call for Evidence, Investor responses to questions 19 and 25 of the Call for Evidence.
[180] Issuer responses to questions 25 and 26 of the Call for Evidence.

CRAs, it does help users to understand the accuracy of credit ratings issued by CRAs by reference to past ratings. Publishing data on the performance of credit ratings issued by new entrants and SME CRAs through the CEREP database can increase their visibility over time. This should also help them to overcome the perceived reputational barrier to entry in time, as the quality of their credit ratings starts to be recognised by issuers and investors.

299. CRAs are required to disclose lists of the credit ratings they issue each year to ESMA, indicating the proportion of the total credit ratings listed which were unsolicited.[181] Since 2011 CRAs have also reported unsolicited ratings through the CEREP database.[182] The majority of CRAs who responded to the Call for Evidence explained that they do issue unsolicited credit ratings.[183] However, one respondent explained that these may not all be reported to ESMA, for example, as unsolicited ratings are not necessarily made public.[184]

5.2.3.2 The European Rating Platform and the SFI website

300. The 2013 amendments to the CRA Regulation introduced the requirement to set up a website for disclosures relating to SFIs in Article 8b[185] and the European Ratings Platform (ERP) in Article 11a. One of the aims of these tools was to stimulate competition by increasing the visibility of smaller CRAs and new entrants and encouraging the production of unsolicited ratings.

301. The CRA Regulation intended for the ERP to be used as a means of increasing transparency and helping to stimulate competition by allowing SME CRAs to gain visibility. However, it was also recognised in the Regulation that investor-pays ratings will not be included in the ERP, as the public disclosure of such ratings would undermine that business model.[186]

302. Whilst it will not be possible to assess the impact of the ERP on competition in the CRA industry until it has been operational for a number of years, it appears that in limiting the business models which benefit from increased visibility, the CRA Regulation may risk implicitly promoting certain business models over others. In order to mitigate the risk of this unintended consequence, the Commission and ESMA should consider whether there are further initiatives which might help to provide equal visibility to CRAs issuing ratings using models which will not be made publically available through the ERP.

5.2.4 Fees charged for credit ratings and ancillary services

303. The 2013 amendments to the CRA Regulation introduced a provision into Annex I Section B 3c through Article 6(2) which requires CRAs to ensure that *'the fees charged to its clients for the provision of credit ratings and ancillary services are not discriminatory and are based on actual costs. Fees charged for credit rating services shall not depend on the level of the credit rating issued by the credit rating agency or on any other result or outcome of the work performed.'*

[181] Annex I Section E 2(c) of the CRA Regulation.
[182] Commission Delegated Regulation 446/2012 of 21 March 2012 with regard to regulatory technical standards on the content and format of ratings data periodic reporting, referred to in footnote 21 above.
[183] CRA responses to questions 7-8 of the Call for Evidence.
[184] CRA response to questions 7-8 of the Call for Evidence.
[185] The overall effectiveness of this provision will be considered in section 6 below. As the provision has not yet been implemented, its impact is not considered further in this section.
[186] See Recital 31 of Regulation 462/2013 referred to in footnote 2 above.

304. Article 11(3) of the CRA Regulation requires CRAs to provide an annual report to ESMA that lists the fees charged by CRAs for credit ratings and ancillary services and provides its pricing policies, including the fee structure and pricing criteria in relation to credit ratings for different asset classes.

305. This was supplemented in 2013 with Article 21(4b)(b) of the CRA Regulation which empowered ESMA to adopt Regulatory Technical Standards in order to ensure the uniform reporting of this information. The Regulatory Technical Standards on Fees[187] entered into force on 25 January 2015 and the initial reports of pricing policies were provided by CRAs in February 2015. ESMA is reviewing these reports as a part of the development of its supervisory strategy in this area. ESMA aims to finalise this strategy in 2016, once it has been able to assess the initial fees data reported by CRAs.

306. The objectives of these provisions were to mitigate conflicts of interest and promote competition in the CRA industry. However, in order to be able to achieve these objectives through supervision, ESMA needs to ensure that it can draw on a clear definition of ancillary services and that it is able to take action to enforce the provisions regarding fees. The CRA Regulation currently contains only a partial definition of ancillary services in Annex I Section B point 4. This states that:

> *'A credit rating agency may provide services other than* [the] *issue of credit ratings (ancillary services). Ancillary services are not part of credit rating activities; they comprise market forecasts, estimates of economic trends, pricing analysis and other general data analysis as well as related distribution services.'*

307. ESMA notes that this definition has been interpreted differently by different CRAs. For example, some CRAs conduct all activities which do not involve the actual issue of a credit rating through sister companies and do not report these activities, or the revenues generated through these activities, to ESMA.

308. In order to properly assess the competitive dynamics of the sector and make the most effective use of its powers of fee supervision, ESMA needs to receive uniform reports from CRAs of revenues generated for all of the ratings-related services provided by CRAs, from ratings assessments and evaluation services to reports, to ratings data and database licences. ESMA notes that there are several projects currently underway at EU and international level in this regard, both within ESMA and through IOSCO Committee 6.[188]

309. ESMA is committed to making full use of the enforcement powers available to it and intends to be more active in its enforcement work going forward.[189] There are a number of specific fee related infringements at ESMA's disposal, such as failure to provide a list of ancillary services, [190] or to establish adequate policies and procedures.[191]

[187] Referred to in footnote 38 above.
[188] See ESMA 2015/280, ESMA Supervision of Credit Rating Agencies and Trade Repositories, Annual Report 2014 and Work Plan, 16 February 2015, referred to in footnote 140 above.
[189] *Ibid*. See also ESMA 2015/935, ESMA Strategic Orientation 2016-2020, 15 June 2015, available at: https://www.esma.europa.eu/system/files/2015-935_esma_strategic_orientation_2016-2020.pdf, last accessed 27.08.2015.
[190] pursuant to Annex III part II point 5 of the CRA Regulation.
[191] as per Annex III part I point 11 of the CRA Regulation.

310. However, in order to achieve the objectives of the Regulation to facilitate fair competition in the CRA industry and allow ESMA to ensure full compliance with the provisions of the CRA Regulation relating to fees, ESMA recommends the introduction of a specific regulatory infringement to address the concerns in Annex I Section B 3c of the CRA Regulation that the level of fees charged by CRAs should reflect the actual costs of providing these services.

311. Responses to the Call for Evidence demonstrate the need for effective supervision in this area as more than half of the responses from issuers noted that some of the largest CRAs operating globally have unilaterally imposed regular fee increases and other requirements on customers.[192]

312. Given the role played by CRAs in facilitating access to finance, in particular by SME issuers and investors, ESMA and the Commission should seek to improve ESMA's supervisory effectiveness in this area as part of the development of a Capital Markets Union.[193]

5.2.5 Encouraging the use of smaller CRAs and new entrants

313. Articles 8c and 8d of the CRA Regulation were introduced as a part of the 2013 amendments to the CRA regulation. They were designed to stimulate competition between CRAs and encourage the use of smaller CRAs and new market entrants.

314. Article 8c of the CRA Regulation sought to achieve this by requiring issuers of SFIs to obtain at least two credit ratings.[194] Article 8d then complements this more generally by requiring issuers or related third parties to consider using a CRA with less than a 10% market share in cases where they use two or more CRAs. Article 8d requires ESMA to publish a calculation of CRAs' market shares for this purpose and specifies that this calculation should be made by using annual revenues from credit rating activities and ancillary services.

315. Article 8d of the CRA Regulation states that where an issuer or related third party intends to appoint at least two CRAs for the rating of an issuance or an issuer, the issuer or a related third party shall consider appointing at least one CRA with no more than 10% of the total market share, provided that the issuer or related third party considers it as capable of rating the relevant issuance or entity, and that one of these smaller CRAs is available to provide a rating. Article 8d further provides that where the issuer or related third party does not appoint at least one of these smaller CRAs, this shall be documented.

316. Member States are responsible for the supervision and enforcement of these obligations at national level in accordance with Article 25a of the CRA Regulation. ESMA seeks to encourage Sectoral Competent Authorities (SCAs) to consider adopting common approaches to supervision wherever possible. SCAs are aware that the development of a common approach is desirable in this area, both in order to create legal certainty for issuers and to reduce the scope for issuers to engage in regulatory arbitrage between Member States.

[192] Issuer responses to questions 8 and 9 of the Call for Evidence.
[193] See Section 3.1.1 above for information regarding the use of credit ratings to attract investment.
[194] The impact of Article 8c will be assessed in Section 6 below on provisions relating to structured finance instruments.

317. Once SCAs had been appointed in the majority of Member States in 2014, ESMA's CRA Technical Committee established a subgroup with the objective of considering how to interpret the requirements of these articles and to raise awareness of the obligations they place on issuers and related third parties.

318. The subgroup, supported by ESMA and the Commission, is currently considering how best to ensure the effective implementation of these articles at national level. As these provisions are still being implemented, it is difficult to assess their impact on competition between CRAs at this point in time.

319. The Call for Evidence asked issuers and investors about their use of multiple credit ratings and also asked CRAs and users of credit ratings to explain the impact that Articles 8c and 8d had had on their business to date.[195] The responses have provided a number of general insights into the use of multiple credit ratings, have raised concerns regarding the implementation of Article 8d and have highlighted potential difficulties with the market share calculation which the article requires ESMA to provide for these purposes.

5.2.5.1 Use of multiple credit ratings

320. In the Call for Evidence, ESMA asked issuers how many credit ratings they solicited for each type of instrument they wanted to market and asked users of credit ratings what impact multiple credit ratings of the same instrument had on their investment or business decisions.

321. Responses from issuers varied according to both the type of issuer or entity and the instruments for which they were seeking ratings. Some sovereign issuers noted that they did not have any solicited ratings, or that they had only one solicited rating and a number of unsolicited ratings, whereas others obtained ratings from all of the three largest CRAs operating internationally.[196] Companies seeking corporate ratings also adopted different approaches. Some issuers explained that they seek one credit rating in general but will obtain two credit ratings if they are launching a US bond issue or are issuing asset backed securities.[197] Other issuers explained that they automatically seek two credit ratings for all publically rated transactions but only one for private transactions[198] or when issuing commercial paper.[199] Six respondents noted that they generally sought three ratings for most instruments. The reasons for this included the need to cover diverse investor requirements, including the specifications of fund mandates, to ensure resilience in the face of changes in ratings methodologies by some CRAs, or to attract international investors.[200]

322. Responses from investors as to the impact of multiple credit ratings varied. Whilst it was generally recognised that it is helpful to have more than one opinion in decision making,[201] some investors highlighted that they only took into account credit ratings from the three largest CRAs operating globally in making investment

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[195] The results of the analysis regarding Article 8c and its relationship to Article 8d are presented in Section 6 below.
[196] Issuer responses to questions 3-5 of the Call for Evidence.
[197] Issuer responses to questions 3-5 of the Call for Evidence.
[198] Issuer responses to questions 3-5 of the Call for Evidence.
[199] Issuer responses to questions 3-5 of the Call for Evidence.
[200] Issuer responses to questions 3-5 of the Call for Evidence.
[201] See for example *Credit Rating Agencies: Meeting the needs of the market?* Angus Duff and Sandra Einig, 1 January 2007 available at: https://www.icas.com/__data/assets/pdf_file/0011/7868/124-Credit-Rating-Agencies-Meeting-the-Needs-of-the-Market-ICAS.pdf, last accessed 28.08.2015.

decisions.[202] Others noted that the most common practice is to consider the lower of the two or three ratings available or consider the average of the three.[203]

323. One association noted that one external rating should be sufficient, reflecting investor views that they would rather minimise their reliance on external credit ratings in favour of their own internal credit assessments.[204] A separate association noted that they did not believe multiple credit ratings to be fundamentally safer or more helpful than a single credit rating issued by a CRA with recognised expertise.[205]

324. It is not currently possible to determine the scope of the markets on which Article 8d might have an impact as the number of entities and instruments which have multiple ratings cannot be identified through the CEREP database. However, the ERP will allow investors to see which CRAs have issued a credit rating on a particular entity or instrument so ESMA will be able to carry out this assessment in future.

5.2.5.2 Lack of awareness

325. Regarding the implementation of Article 8d of the CRA Regulation, in general terms, the responses from smaller CRAs and new market entrants expressed concern about the lack of awareness of these provisions and called for guidance to be issued at EU or Member State level.

326. Some respondents raised concerns that Article 8d will not have a significant impact on competition between CRAs because it is not mandatory[206] and that the requirements to *'consider'* and *'document'* will be unlikely to stimulate meaningful change in issuers' behaviour as they only want to seek ratings from particular CRAs with name recognition to meet national regulatory requirements or to include in their prospectuses.[207]

327. In order to ensure that Article 8d is applied in a meaningful way, one CRA suggested that issuers should be required to document the evaluation process in a clear, transparent and explicit way or should be given targets for the number of entities or instruments to be rated by a smaller CRA or new market entrant.[208]

328. However, these views were not echoed by issuers and investors. Some stressed the need to let issuers decide for themselves how many ratings they obtain and which CRAs they use.[209] Some issuers expressed concerns about the cost and administrative burden of compliance with Article 8d of the CRA Regulation, in particular relative to the value added by this provision.[210] Conversely, some issuers stated that the costs of documenting the CRAs selected were relatively low,[211] but that the costs of actually obtaining multiple ratings or engaging an additional CRA were significant.[212] ESMA, the Commission and the SCAs will be mindful of these concerns in their future work in this area.

[202] Investor responses to question 16 of the Call for Evidence.
[203] Investor responses to question 16 of the Call for Evidence.
[204] Investor responses to question 16 of the Call for Evidence.
[205] Investor responses to question 16 of the Call for Evidence.
[206] CRA responses to question 10 of the Call for Evidence.
[207] CRA responses to question 10 of the Call for Evidence.
[208] CRA responses to question 10 of the Call for Evidence.
[209] Investor response to question 17 of the Call for Evidence.
[210] Issuer responses to question 10 of the Call for Evidence.
[211] Issuer responses to question 10 of the Call for Evidence.
[212] Issuer responses to question 10 of the Call for Evidence.

5.2.5.3 Market share calculations for the purposes of Article 8d of the CRA Regulation

329. A further issue which has raised concerns for ESMA regarding the potential impact of Article 8d of the CRA Regulation relates to the use and effectiveness of the market share calculation required by the article. Article 8d(2) of the CRA Regulation requires ESMA to publish a list of EU registered CRAs on its website every year, *'indicating their total market share and the types of credit ratings issued, which can be used by the issuer as a starting point for its evaluation.'*

330. Article 8d(3) then states that *'total market share shall be measured with reference to annual turnover generated from credit rating activities and ancillary services, at group level'*.

331. Many respondents to the Call for Evidence pointed to ESMA's market share calculation for the purposes of Article 8d to support their view that three largest CRAs operating globally had significant market power. However, the market shares calculated for the purposes of Article 8d should be used with caution as these are calculated not only on the basis of revenues from credit ratings, but also on the basis of revenues from ancillary services.

332. In addition, these market share calculations may be misleading if relied on more widely, given the concerns raised in Section 5.2.4 above about the absence of a clear definition of ancillary services. This is because the revenue information provided by some CRAs includes revenues from services such as ratings data feed and ratings research and reports whereas this is excluded from the information provided by others. This has the effect of understating the position of some of the larger CRAs and overstating the position of others, which are typically smaller CRAs and new market entrants.[213]

333. Without prejudice to ESMA's on-going work on ancillary services, ESMA therefore recommends that revenues from ancillary services should be removed from the calculation of market shares for the purposes of Article 8d going forward and that these should not be used as an overall indication of CRAs' market shares for the reasons set out in Section 3 above.

334. In addition, in order to help ensure that Article 8d achieves its aim of stimulating competition by focusing on the ability of new entrants and smaller CRAs to provide quality ratings for different asset classes at Member State and EU level, ESMA believes that a more granular market share calculation would be helpful.

335. As explained in Section 3 above, the CRA industry consists of different markets for different rated entities and instruments and there is currently no single EU market for the issue of credit ratings of any given asset class, but rather a number of national markets and international markets. The calculation of CRAs' market shares in individual asset classes at Member State and at EU level would therefore help

[213] ESMA notes that these concerns may also have an impact on the revenues reported by CRAs for the calculation of supervisory fees payable to ESMA.

issuers and investors to assess CRAs' abilities and experience of rating these different asset classes.[214]

336. From the share of supply data presented in Section 3 above, it also seems that carrying out more granular market share calculations could help avoid the unintended consequences of using an overall market share threshold of 10%. For example, an unintended consequence could arise where a CRA with a large share of supply in certain asset classes in some Member States is appointed pursuant to Article 8d to provide ratings for those asset classes in those Member States where they have a strong position, simply because they have an overall market share of less than 10%.

337. ESMA's recently published guidelines on periodic reporting[215] noted that ESMA will consider publishing further information alongside the market share calculation for the purposes of Article 8d and would welcome the opportunity to consider this issue further with the Commission.

5.3 Effectiveness of provisions in stimulating competition

338. In this Subsection, ESMA considers the extent to which the increased visibility arising from the implementation of the CRA Regulation has resulted in more effective competition between CRAs operating in the EU and the impact that the barriers to entry identified by the respondents to the Call for Evidence may have on competition between CRAs.

5.3.1 Increased visibility

339. CRAs now have greater visibility overall, which may be attributed to the registration process, ESMA publications such as the list of registered CRAs published pursuant to Article 8d, databases such as CEREP and CRAs' public disclosures, for example the disclosures of methodologies and transparency reports. The introduction of the ERP should also give CRAs greater visibility in future.

340. The overall effect of these disclosures on competition between CRAs is unclear. On the one hand, the increased visibility may lead to an increased use of smaller CRAs and new entrants. On the other hand, these disclosures may make it easier for the largest CRAs to coordinate their behaviour to the detriment of issuers, investors and other users of credit ratings, for example by limiting the choice of products and services available, by not investing in innovation or by charging high fees.

341. ESMA sought to test this through the Call for Evidence by asking CRAs what impact disclosures by other CRAs' had on their business development. The responses to the question were mixed. Whilst CRAs admit that they can learn about CRAs' activities through their transparency reports and about their methodologies through information published on their websites, very few admitted that these had

[214] For those CRAs looking to expand to rate a new asset class but not currently generating revenues from that asset class, information could be presented alongside the market share calculation to demonstrate their experience, for example links to the CRAs' websites where their research reports or information about their unsolicited credit ratings could be accessed.
[215] ESMA 2015/609 Guidelines on periodic information to be submitted to ESMA by Credit Rating Agencies, 23 March 2015 referred to in footnote 116 above.

any impact on the way in which they developed their business or on their ratings outcomes.[216]

342. The data presented in Section 3 above suggests that whilst measures to increase transparency may have increased awareness of the existence of smaller CRAs and new entrants, increasing the visibility of CRAs has not yet resulted in significantly greater use of smaller CRAs and new entrants by issuers and investors. This is reflected by the fact that the number of ratings being issued by these CRAs still accounts for only a very small amount of the total number of ratings being issued in the EU.

5.3.2 Use of unsolicited credit ratings

343. It appears that it may take more time for this increase in visibility to result in the greater use of smaller CRAs and new entrants by market participants because in order to gain market share in a given asset class, smaller CRAs and new entrants need to be able to demonstrate the quality of their products and services. One way for CRAs to do this is to invest in producing research and unsolicited ratings for market participants.[217] However, this can be costly for CRAs. Even some of the largest CRAs operating globally note that by choosing to produce unsolicited ratings they are unable to invest in developing other parts of their business to the same extent as if they were being paid to produce these ratings.[218]

344. Responses to the Call for Evidence suggest that unsolicited ratings are being produced by the majority of CRAs. These CRAs explained that they issue unsolicited ratings, for example of sovereigns[219] or corporates,[220] either to support the issue of other ratings in those countries or more generally in those cases where there is sufficient information available and sufficient investor demand.[221]

345. Only four of the CRAs who responded to the Call for Evidence stated that they did not produce unsolicited ratings.[222] Some explained that this reflects the needs of issuers, who find it difficult to deal with *'unwanted'* ratings.[223] Other CRAs highlighted that the issue of unsolicited credit ratings can be labour intensive and can generate reputational risk.[224]

346. Some CRAs explained that in their view the issue of unsolicited ratings can stimulate competition.[225] Unsolicited ratings can do this by allowing CRAs to become a credible source of information or to increase their coverage of certain sectors or industries.[226]

347. In order for unsolicited ratings to be an effective means of stimulating competition between CRAs, they need to result in the issue of an increased number of solicited ratings by smaller CRAs and new entrants. However, the data presented in Section 3

[216] CRA responses to question 6 of the Call for Evidence.
[217] CRA responses to questions 7- 8 of the Call for Evidence.
[218] CRA response to questions 7- 8 of the Call for Evidence.
[219] CRA responses to questions 7- 8 of the Call for Evidence.
[220] CRA responses to questions 7- 8 of the Call for Evidence.
[221] CRA responses to questions 7- 8 of the Call for Evidence.
[222] CRA responses to questions 7- 8 of the Call for Evidence.
[223] CRA response to questions 7- 8 of the Call for Evidence.
[224] CRA response to questions 7- 8 of the Call for Evidence.
[225] CRA responses to questions 7- 8 of the Call for Evidence.
[226] CRA response to questions 7- 8 of the Call for Evidence.

above does not show that the number of ratings issued by smaller CRAs and new entrants has significantly increased in recent years.

348. This is reflected in a number of the responses to the Call for Evidence. Some CRAs noted that they do not believe that the production of unsolicited ratings has had any identifiable impact on competition between CRAs to date.[227] This may be as a result of concerns about the quality of some unsolicited credit ratings. Indeed, a number of CRAs stressed that unsolicited ratings should only be issued where sufficient information is available.[228] One respondent stated their belief that some unsolicited ratings are currently being assigned on the basis of very little information with no interaction with the company and no information about its future plans.[229] Another respondent expressed concerns about the ways in which unsolicited ratings were being used to win business by CRAs, suggesting that some CRAs issued ratings on an unsolicited basis with the implication that if the issuer were to pay for a solicited rating in future, this would allow them to achieve a better rating outcome.[230]

349. It is important that unsolicited ratings are prepared in accordance with the minimum quality standards set out in the CRA Regulation and that the participation status of the rated entity is clearly disclosed.[231] Furthermore, in order to comply with the provisions of the CRA Regulation regarding conflicts of interest, unsolicited ratings must never be used to suggest that issuers could pay to obtain a higher rating.[232] ESMA will continue to consider this issue through its on-going supervision.

5.3.3 Little increase in competition

350. Increased visibility has not necessarily stimulated competition between CRAs at EU level. However, the share of supply data presented in Section 3 above suggests that there are some Member States where smaller CRAs have been starting to compete against the larger, more established CRAs in categories such as corporate credit ratings. This was reflected in the responses to the Call for Evidence received from a number of larger CRAs and those holding strong positions in certain local markets.[233]

351. ESMA sought to understand whether competition between CRAs had increased by asking respondents to the Call for Evidence how CRAs compete and whether the nature of competition between CRAs had changed since the entry into force of the CRA Regulation.

352. Many of the issuers and users of credit ratings that responded to the Call for Evidence explained that they had not seen a lot of evidence of competition between CRAs[234] and some noted that they did not believe that there had been many changes in CRAs' behaviour since the entry into force of the CRA Regulation.[235] This was echoed by a number of CRAs.[236] Those respondents which were aware of competition between CRAs explained that in their view, CRAs competed on the

[227] CRA responses to questions 7-8 of the Call for Evidence.
[228] CRA responses to questions 7-8 of the Call for Evidence.
[229] CRA response to questions 7-8 of the Call for Evidence.
[230] CRA response to questions 7-8 of the Call for Evidence.
[231] Article 10 of the CRA Regulation and Annex I Section D.
[232] As set out in Annex I Section B 3c of the CRA Regulation.
[233] CRA responses to question 21 of the Call for Evidence.
[234] Issuer responses to question 26 of the Call for Evidence.
[235] Issuer responses to question 27 of the Call for Evidence.
[236] CRA responses to question 22 of the Call for Evidence.

geographic coverage[237] and the quality of the services offered[238] as well as on the basis of their relationships with issuers[239] and investors[240] and the transparency of and differences in their methodologies.[241]

353. Some respondents noted that CRAs compete on the level of fees charged.[242] However, more than half of the issuers and a number of other users of ratings who responded to the Call for Evidence reported that frequent fee increases had been imposed by the largest CRAs operating globally for ratings and related data products and services ranging from 1% per annum to 300% over 5 years. Some respondents noted that the fees charged were frequently increasing without commensurate benefits to justify them such as new or improved quality products or services.[243]

354. The fact that these CRAs have been able to increase the fees charged significantly is indicative of their market power. Although this may be attributable to the oligopolistic nature of the markets in general terms, it suggests that there is little effective competition between CRAs. A lack of competition could mean that these CRAs may not be incentivised to ensure that the products they provide are of high quality or to invest in innovation[244] and could allow CRAs to use their market power to restrict the number of credit ratings being produced, or to price some issuers and investors out of the markets for credit ratings, to the detriment of European businesses, as noted in Section 3.3.1 above.

5.3.4 Barriers to entry

355. When firms raise prices above competitive levels in competitive markets, this, in theory, gives new entrants the opportunity to enter the market and pick up the business of those customers who are not willing to accept the price increases. However, the ability of new entrants to be able to do this depends on the barriers to entry and expansion existing in the industry.[245] As noted in Section 3 above, there are a number of barriers to entry into the CRA industry, including regulation and the need to overcome the reputational barrier to entry by establishing a network of issuers and investors.

356. In order to better understand the constraints imposed by these barriers to entry, ESMA asked CRAs through the Call for Evidence to explain whether they would be able to start offering credit ratings for asset classes they did not currently rate if they wanted to diversify their business. The responses show that there are a number of smaller CRAs and new entrants active in one or more national markets within the EU which are looking to win more business within the EU as well as at international level.[246] The entry barriers that CRAs identified included regulation and the need to build a reputation for themselves as a provider of credit ratings of a particular asset class.[247]

[237] Issuer responses to question 25 of the Call for Evidence.
[238] Issuer responses to question 25 of the Call for Evidence.
[239] Issuer responses to question 25 of the Call for Evidence.
[240] Issuer responses to question 25 of the Call for Evidence.
[241] Issuer responses to question 25 of the Call for Evidence.
[242] Issuer responses to question 25 of the Call for Evidence.
[243] Issuer responses to questions 8, 9 and 27 of the Call for Evidence.
[244] Issuer responses to questions 8 and 9 of the Call for Evidence.
[245] Referred to in Section 3.3.4 above.
[246] CRA responses to question 20 of the Call for Evidence.
[247] CRA responses to question 20 and 23 of the Call for Evidence.

5.3.4.1 Regulation and costs

357. Regulation is a general barrier to entry in many industries. However, where all firms have to comply with the same regulatory requirements, the costs associated with compliance may have a disproportionate impact on SMEs, which in turn makes it harder for them to compete against larger firms.

358. The responses to the Call for Evidence suggest that in general terms, the costs of compliance of some of the larger CRAs operating in the EU may account for less than 1% of their total revenues, excluding supervisory fees. However, some smaller CRAs have estimated that their compliance costs may account for up to 10% of their total annual revenues.

359. Whilst compliance with the standards established by the CRA Regulation is essential in seeking to ensure the production of independent high quality credit ratings, ESMA could further examine CRAs' compliance costs and consider whether there are areas where it could be possible to simplify reporting in order to reduce the compliance costs of small and medium-sized CRAs. However, ESMA will only consider further measures where there is no risk that these will hinder ESMA's supervisory effectiveness or have a negative impact on the quality of the credit ratings issued by the CRAs concerned.[248]

360. Furthermore, for the reasons set out in Section 4 above, the Commission should consider whether there is scope to amend the wording of the current exemptions so that they are aligned with other sectoral regulation for SMEs, for example by allowing exemptions to be granted to companies of up to either a certain turnover threshold or employing up to a certain number of employees. This would help to reflect the needs of small and medium-sized CRAs and encourage them to expand their operations to better compete with the largest CRAs operating globally.[249]

5.3.4.2 Reputational barriers to entry

361. Responses to the Call for Evidence showed that the emergence of new entrants might be hindered by their lack of investor recognition.[250] It is logical that in order for CRAs to become recognised, they need to demonstrate the quality and accuracy of their credit ratings. As credit ratings are forward looking by nature, it takes time to determine whether opinions held are actually justified.

362. Some respondents noted that in their view, some smaller CRAs do not currently have the detailed level of knowledge of their sector or of the country in which their business is operating that they would require from a CRA.[251] Other respondents noted that in order for a CRA to successfully enter a new market they need to demonstrate the quality or their offering or a methodology which differentiates them from their competitors,[252] or find a number of investors who are willing to support their entry into the market for a particular asset class.[253]

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[248] See for example Investor response to question 25 of the Call for Evidence.
[249] CRA response to questions 17 and 24 of the Call for Evidence.
[250] Issuer responses to questions 25 and 26 of the Call for Evidence, Investor responses to question 25 of the Call for Evidence.
[251] Issuer responses to question 6 of the Call for Evidence, Investor response to question 19.
[252] Investor responses to question 25 of the Call for Evidence.
[253] CRA response to question 2 of the Call for Evidence.

363. As highlighted in Section 5.3.2 above, CRAs need to be proactive in demonstrating the quality of their work through the issue of research reports, ratings commentaries and unsolicited ratings.[254] However, it appears that CRAs may need to take further steps to promote the quality of their offering in order to help overcome this reputational barrier to entry. One association of corporate treasurers provided an example of good practice in this respect by explaining that they had organised meetings for their members with smaller CRAs and new entrants in order to better help them understand the quality of their services and they experience they can offer.[255]

5.3.4.3 Existing market practices

364. CRAs have raised concerns that in terms of barriers to entry, current market practices are preventing them from competing on the merits of their credit ratings to a greater extent than their lack of reputation. Some CRAs pointed to the lack of a formal process for applying for ECAI status within the ECAF[256]as preventing them from competing in particular markets, such as the markets for SFIs.[257] Others explained that they have not been able to compete against the largest CRAs operating globally as investors are only able to use ratings from particular CRAs under the terms of their investment mandates or transaction documents.[258]

365. One respondent to the Call for Evidence noted that it would not be possible to stop paying for a rating from a particular CRA during the life of an instrument without investor consent as the rating is an important part of, and in some cases a requirement of, their investment.[259] Another respondent explained that *'it is recognised that changing CRA can be regarded with suspicion and therefore there is a lot of inertia'*.[260] This was mirrored in another response from an issuer which explained that it continually renews the agreement in place with its current CRA as it would be too complicated to switch to another CRA.[261]

366. In practice, this means that a financial instrument may be supported by a credit rating from a particular CRA for its duration, in order to attract initial investors and appeal to secondary market participants. For this reason, a 10 year bond would ordinarily be rated by the same CRA for the whole 10 years, with annual surveillance fees payable to the CRA. Indeed, many respondents to the Call for Evidence noted that they had long standing relationships with their preferred CRAs for both credit ratings and ancillary services. Some noted that their agreements were of an unspecified duration[262] and had in a few instances been in place for more than 20 years.[263] Most respondents explained that their agreements were stated to be for 1-3 year periods[264] but were automatically reviewed or renewed.[265] Of the 23 responses to this question, only a minority noted that they selected their CRAs by competitive tender[266] or on a deal-by-deal basis.[267] One respondent also noted that the agreement

[254] Issuer responses to questions 25 and 26 of the Call for Evidence.
[255] Issuer response to question 26 of the Call for Evidence.
[256] Please see Section 3 above for more information on ECAF.
[257] CRA responses to question 10, 19, 23 and 24 of the Call for Evidence, Issuer response to question 28 of the Call for Evidence.
[258] CRA responses to question 10 and 23, Issuer responses to question 3-5, and 13 of the Call for Evidence.
[259] Issuer response to question 13 of the Call for Evidence.
[260] Issuer response to question 13 of the Call for Evidence.
[261] Issuer response to question 3 of the Call for Evidence.
[262] Issuer responses to question 13 of the Call for Evidence.
[263] Issuer responses to question 13 of the Call for Evidence.
[264] Issuer responses to question 13 of the Call for Evidence.
[265] Issuer responses to question 13 of the Call for Evidence.
[266] Issuer responses to question 13 of the Call for Evidence.

in place with their current CRA was exclusive, requiring them to have everything they wished to issue rated by the CRA in question.[268]

367. Credit ratings are not homogenous products, as they are developed on the basis of different methodologies.[269] This may make it difficult for one CRA to demonstrate that their credit ratings are of an equivalent quality to the credit ratings issued by another CRA and for issuers to switch between CRAs during the life of an instrument. There are a number of on-going initiatives at EU level which could help to mitigate these difficulties.

368. In the past, only the credit ratings from a limited number of CRAs which had been recognised as ECAIs by national supervisory authorities could be used in the calculation of regulatory capital requirements for banks and insurance companies. However, since the entry into force of the Capital Requirements Regulation[270] all EU registered CRAs have had ECAI status, as noted in Section 3 above. This means that in future, all EU registered CRAs will be able to provide credit ratings which can be used as external credit assessments for capital adequacy purposes.[271]

369. In order to facilitate this transition the Capital Requirements Regulation and Solvency II[272] require the ESAs to prepare three sets of Implementing Technical Standards (ITS) which will demonstrate how the credit ratings from different CRAs correspond to different credit quality steps.

370. The first set of ITS will provide a mapping of credit ratings to risk weights pursuant to Article 136 of the Capital Requirements Regulation. The ITS will specify the levels of risk that should be used to characterise each credit quality step and the elements that characterise the degree of risk expressed by a credit rating on the basis of quantitative and qualitative factors. The ITS were published for consultation in 2014.[273]

371. The second ITS were being prepared in accordance with Article 270 of the Capital Requirements Regulation. This requires the European Banking Authority (EBA) to provide a mapping for the assessment of securitisation positions which specifies the correspondence between credit ratings and credit quality steps to determine the risk weightings to be given to credit ratings on securitisations using either the Standardised Approach or the Internal Ratings Based approach.[274] The draft ITS were published for consultation by the EBA on 7 May 2015 and the consultation period ran until 7 August 2015.[275]

372. A further mapping exercise is being carried out by the European Insurance and Occupational Pensions Authority (EIOPA) pursuant to Article 44(4a) of Solvency II

[267] Issuer response to question 13 of the Call for Evidence.
[268] Issuer response to questions 3-5 of the Call for Evidence.
[269] As explained in Section 3 above.
[270] Regulation 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176/1 of 27.6.2013 referred to in footnote 13 above.
[271] For more information about mapping exercises, please see ESMA's Report on the possibility of establishing one or more mappings of credit ratings published on the European Rating Platform.
[272] Directive 2009/138 of 25 November 2009 on the taking up and pursuit of the business of Insurance and Reinsurance, OJ L 335, 17.12.2009, as amended by the Omnibus II Directive referred to in footnote 13 above.
[273] http://www.eba.europa.eu/regulation-and-policy/external-credit-assessment-institutions-ecai/draft-implementing-technical-standards-on-the-mapping-of-ecais-credit-assessments, last accessed 31.07.2015.
[274] http://www.eba.europa.eu/regulation-and-policy/external-credit-assessment-institutions-ecai/its-on-the-mapping-of-ecais-credit-assessments-for-securitisation-positions
[275] A copy of the consultation paper is available on the EBA's website at: https://www.eba.europa.eu/documents/10180/1065442/EBA-CP-2015-08+CP+on+ITS+on+Mapping+of+ECAIs+Credit+Assessments.pdf, last accessed 24.07.2015.

which requires EIOPA to develop ITS with regard to the procedures for assessing external credit assessments. EIOPA launched a public consultation on the draft ITS on 2 December 2014 and published its final report on 30 June 2015.[276]

373. As a result of these exercises all EU registered CRAs should be able to provide credit ratings which can be used for regulatory capital purposes by financial institutions in future. This could help smaller CRAs and new entrants to increase their visibility and to demonstrate the quality of their credit ratings. This may make it easier for these CRAs to persuade market participants to use their credit ratings in future transactions, stimulating competition between CRAs in the longer term.

[276] EIOPA's final report is available at https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-15-117_Final_report_ITS_Assessing_credit.pdf, last accessed 24.07.2015.

6 Impact of provisions relating to Structured Finance Instruments

374. In order to provide the advice required by Article 39(4) of the CRA Regulation, this section reviews the provisions which were introduced as a part of the 2013 amendments to the CRA Regulation regarding ratings of SFIs. A general overview of the situation in the markets for credit ratings of SFIs in the EU is provided in Section 3 above.

375. An SFI is defined in Article 3(1)(l) of the CRA Regulation as a financial instrument or other assets resulting from a securitisation transaction or scheme:

'whereby the credit risk associated with an exposure or pool of exposures is tranched, having both of the following characteristics:

(a) payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures; and

(b) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme'.

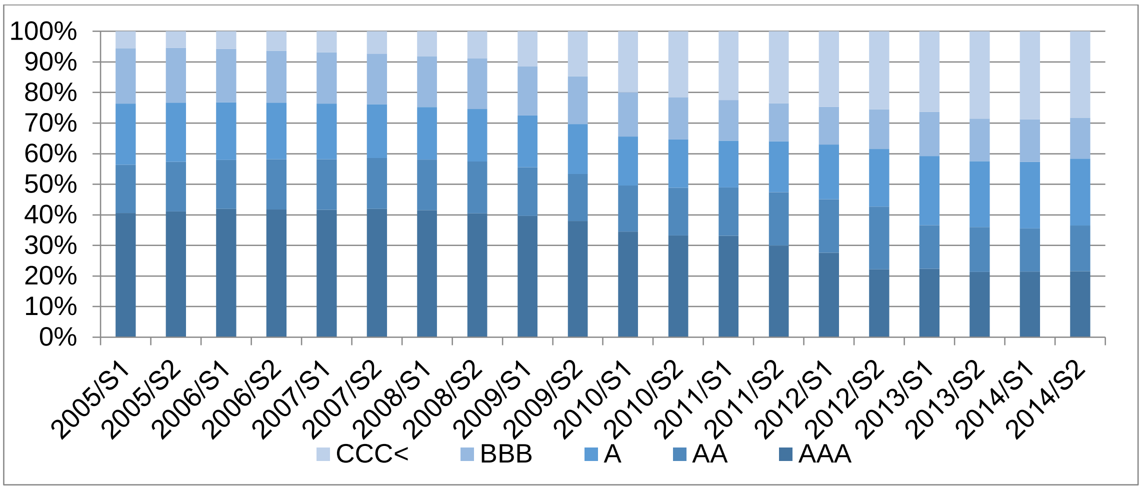
376. For the purposes of the CRA Regulation, the definition of securitisation[277] is provided by Article 4(1)(61) of the Capital Requirements Regulation.[278] This explains that a securitisation consists of multiple tranches, each of which has its own credit risk profile. This means that different tranches of a securitisation are typically rated differently. The Capital Requirements Regulation also provides a definition of re-securitisation. Article 4(1)(63) of this regulation states that a re-securitisation is *'a securitisation where the risk associated with an underlying pool of exposures is tranched and at least one of the underlying exposures is a securitisation position'.*

377. SFIs played a particular role in the 2008 financial crisis. Whilst the average rating of several asset classes deteriorated during this period, SFIs experienced the most pronounced drop in the EU as the proportion of non-investment grade transactions increased from 6% at pre-crisis level to 29% in 2014 as shown in figure 20 below.

[277] This definition co-exists with other related definitions of securitisation provided in other EU legal instruments. This issue is analysed and discussed in JC2015/22, Joint Committee Report on Securitisation of 12 May 2015 available at: https://www.eba.europa.eu/documents/10180/950548/JC+2015+022+-+Final+JC+Report+on+securitisation.pdf, last accessed 27.08.2015.

[278] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013, referred to in footnote 13 above.

Figure 20: Distribution of structured finance ratings across credit rating grades



Source: CEREP, ESMA

378. As noted in Section 3 above, there are relatively few CRAs active in the markets for ratings of SFIs in the EU. The table below provides an overview of the CRAs with outstanding ratings on SFIs in the EU. The markets are mainly served by four large CRAs. However, two small CRAs (Scope and Creditreform) have recently started issuing ratings in this category as shown in Table 4 below.

Table 4 – Outstanding ratings of EU structured finance instruments by CRA

CRA	Registration Date	2009	2010	2011	2012	2013	2014
Creditreform	18.05.2011						
DBRS	31.10.2011						
Fitch	31.10.2011						
Moody's	31.10.2011						
S&P	31.10.2011						
Scope	24.05.2011						

Source: CEREP, ESMA

379. Of these 6 CRAs, ESMA understands that none have issued credit ratings on re-securitisations in the EU since the entry into force of Article 6b of the CRA Regulation on 20 June 2013.[279]

380. A range of measures were introduced by the 2013 amendments to the CRA Regulation with the objective of stimulating competition, improving transparency and ultimately restoring investor confidence in SFIs. Three measures are assessed in the following subsections:

[279] ESMA request for information of 29 July 2015.

- Article 6b which specifies the maximum duration of certain contractual relationships with a CRA (mandatory rotation);
- Article 8b which requires the disclosure of information about SFIs;
- Article 8c which requires issuers to obtain multiple credit ratings for SFIs.

6.1 Maximum duration of certain contractual relationships with a CRA (mandatory rotation)

381. This subsection contains an assessment of the requirements in Article 6b of the CRA Regulation. This article states that *'where a credit rating agency enters into a contract for the issuing of credit ratings on re-securitisations, it shall not issue credit ratings on new re-securitisations with underlying assets from the same originator for a period exceeding four years.'* As none of the registered CRAs have assigned new ratings on a re-securitisation in the EU since the entry into force of the 2013 amendments to the CRA Regulation, ESMA has no experience of the practical operation of the provision and no firm evidence base on which to evaluate its impact.

382. The first part of this subsection outlines the mandatory rotation mechanism provided for in Article 6b of the CRA Regulation. It also outlines the problems which Article 6b was intended to address. Finally, it considers some specific questions concerning the functioning of Article 6b raised by Article 39(4) of the CRA Regulation on the basis of responses to ESMA's Call for Evidence, namely:

    - Is the availability of choice sufficient in order to comply with the requirements set out in Article 6b?

    - Would it be appropriate to shorten or extend the maximum duration of the contractual relationship referred to in Article 6b(1) and the minimum period before the credit rating agency may re-enter into a contract with an issuer or a related third party for the issuing of credit ratings on re-securitisations referred to in Article 6b(3)?

    - Would it be appropriate to amend the exemption referred to in the second subparagraph of Article 6b(2)?

383. The second part of this subsection provides an overview of respondents' perceptions of Article 6b of the CRA Regulation and the mandatory rotation of CRAs more generally. In this context the following questions are considered, as required by Article 39(4)-(5) of the CRA Regulation and the recitals to the 2013 amendments to the CRA Regulation:

    - Should the scope of the rotation mechanism referred to in Article 6b be extended to other asset classes?

    - Is it appropriate to use differentiated lengths of periods across asset classes?

    - If the scope of the rotation mechanism were to be extended to other asset classes, should an obligation be introduced that a CRA provide information on the issuer and on the rated financial instruments to the incoming CRA in a handover file at the end of the maximum term of the contractual relationship?[280]

6.1.1 Objectives and functioning of the mandatory rotation provision

384. Article 6b of the CRA Regulation requires the regular rotation of CRAs rating re-securitisations with underlying assets from the same originator. It entered into force on 20 June 2013. The recitals to the CRA Regulation identify the problems which Article 6b was intended to address. Recital 12 states that CRAs and rated entities tend to enter into long-lasting relationships which could compromise the impartiality of the CRA and provide an incentive for overly favourable ratings:

> *'Indeed, credit rating agencies appointed and paid by a corporate issuer have an incentive to issue overly favourable ratings on that rated entity or on its debt instruments in order to maintain the business relationship with such issuer. Issuers are also subject to incentives that favour long-lasting relationships, such as the lock-in effect whereby an issuer refrains from changing credit rating agency as this could raise concerns of investors regarding the issuer's creditworthiness.'*[281]

385. The Commission's 2011 impact assessment referenced a study[282] which demonstrated that the SFI issues of large issuers were rated more favourably than those of smaller issuers of comparable quality during the financial crisis.[283] This was seen as evidence that large issuers could use their bargaining power to achieve higher ratings from CRAs which may not always have been justified.

386. In addition to addressing conflicts of interest and the lock-in effect referred to above, Recital 12 of the 2013 amendments to the CRA Regulation further explained the expected effect of mandatory rotation on competition. According to Recital 12, mandatory rotation could *'have positive effects on the credit rating market, as it would facilitate new market entries and offer existing credit rating agencies the opportunity to extend their business to new areas'.*

387. However, the recitals to the 2013 amendments to the CRA Regulation also recognised that a mandatory rotation requirement could have unintended consequences. Firstly, it could increase costs for issuers and CRAs as it is less costly to carry out monitoring of a credit rating which is already in place than to issue a new credit rating. Secondly, it could impact negatively on the quality of the credit ratings as a new team of analysts would need to familiarise themselves with the file. Thirdly, it could impact negatively the continuity of the credit rating, potentially resulting in sudden upgrades and downgrades that reflect diverging methodologies rather than changes in fundamentals. To address these risks, the requirement was to be phased in gradually and the final provision was designed with an aim of minimising these potential negative effects while maximising the positive impact of the provision[284] in the following ways.

[280] Recital 13 of Regulation 462/2013 referred to in footnote 2 above.
[281] Recital 12 of Regulation 462/2013 referred to in footnote 2 above.
[282] Impact Assessment accompanying the proposal for a Regulation amending Regulation No 1060/2009 on credit rating agencies, SEC (2011) 1354, referred to in footnote 29 above.
[283] *Are all ratings created equal? The impact of issuer size on the pricing of mortgage-backed securities,* Jie (Jack) He, Jun 'QJ' Qian, Philip E. Strahan, July 2011. Available from: https://www2.bc.edu/~strahan/Ratings-July2011.pdf, last accessed 27.08.2015.
[284] Recital 13 of Regulation 462/2013 referred to in footnote 2 above.

388. Firstly, the scope of Article 6b of the CRA Regulation was limited to re-securitisations, which are typically unique transactions. Recital 14 of the 2013 amendments to the CRA Regulation provides that *'when a re-securitisation is created the risk of knowledge being lost by hiring a new credit rating agency is not high. In other words, although there is currently only a limited number of credit rating agencies active in the credit rating market for re-securitisations, that market is more naturally open to competition and a rotation mechanism could be a driver for creating more dynamics in that market.'* As the markets for re-securitisations in the EU had underperformed in the period prior to the adoption of the 2013 amendments to the CRA Regulation, it was thought that the introduction of this provision could help to revive these markets.

389. Secondly, Article 6b of the CRA Regulation sets the maximum period for which the credit rating agency is allowed to rate re-securitisations with underlying assets from the same originator to four years. After four years, a cooling-off period will begin, during which the CRA would not be able to issue ratings on such re-securitisations. This period is to run for the length of the previous contract, but for no longer than four years.[285]

390. Thirdly, the rotation mechanism is structured around the originator of the re-securitisation. The reasoning for this is provided in Recital 16 of the 2013 amendments to the CRA Regulation:

'Re-securitisations are issued out of special-purpose vehicles without any significant capacity to service the debt. Therefore, structuring rotation around the issuer would render the mechanism ineffective. Conversely, structuring rotation around the sponsor would mean that the exemption would almost always apply.'

391. Fourthly, as the Commission understood that the application of a mandatory rotation provision could make it more difficult for new CRAs to establish themselves in these markets if they were unable to retain their clients for more than four years, it was considered appropriate to *'introduce an exemption from the rotation mechanism for small credit rating agencies'*.[286] This exemption is set out in Article 6b(5) of the CRA Regulation which states that the article shall not apply to CRAs employing less than 50 employees in credit rating activities at group level or to those with an annual turnover from credit rating activities of less than €10 million at group level.

392. Fifthly, a general exemption from the requirement is provided in cases where at least four CRAs each rate more than 10% of the total number of outstanding rated re-securitisations. It is the responsibility of the CRA to request information from the issuer on the number of CRAs with contractual relationships for issuing credit ratings on re-securitisations with underlying assets from the same originator and to calculate the percentage of the total number of outstanding rated re-securitisations with underlying assets from the same originator for which each CRA issues ratings.

393. Finally, as noted in Recital 19 of the 2013 amendments to the CRA Regulation *'the requirement only applies to registered credit rating agencies, which are regulated and which provide a service affecting the public interest (credit ratings that can be used for regulatory purposes) under the issuer-pays model and for a particular asset class (re-securitisations).'*[287]

[285] Recital 15 of Regulation 462/2013 referred to in footnote 2 above.
[286] Recital 17 of Regulation 462/2013 referred to in footnote 2 above.
[287] Recital 19 of Regulation 462/2013 referred to in footnote 2 above.

6.1.1.1 Sufficient choice of CRAs

394. As explained above, only four CRAs (Moody's, S&P, Fitch and DBRS) have previously rated re-securitisations in the EU. It is not surprising that additional CRAs have not entered these markets given that there has been limited interest in issuing re-securitisations in the EU following the financial crisis.

395. Article 8c of the CRA Regulation requires all SFIs, including re-securitisations, to be rated by at least two CRAs. As only four CRAs have any experience of rating re-securitisations in the EU, in the event that mandatory rotation were to take place pursuant to Article 6b, an issuer would have no choice but to appoint the two remaining CRAs once the cooling-off period set in. This means that issuers would be prevented from soliciting three credit ratings on the same instrument, which is not uncommon in practice,[288] as doing so would leave the originator of the underlying assets with access to a rating from only one CRA once the cooling-off period had set in.

6.1.1.2 The reference periods

396. Two key reference periods are set out in Article 6b of the CRA Regulation. The first is provided in Article 6b(1), which requires CRAs, where they enter into a contract for the issue of credit ratings on re-securitisations, to refrain from issuing credit ratings on new re-securitisations with underlying assets from the same originator for a period exceeding four years. The length of this maximum period and the subsequent cooling-off period are defined in Article 6b(3) which provides that *'as from the expiry of a contract pursuant to paragraph 1, a credit rating agency shall not enter into a new contract for the issuing of credit ratings on re-securitisations with underlying assets from the same originator for a period equal to the duration of the expired contract but not exceeding four years.'*

397. ESMA asked about the appropriateness of the length of these two periods through the Call for Evidence. The majority of respondents did not express an opinion about this, either due to a lack of experience or because they were generally opposed to the principle of CRA rotation. Some respondents stressed that their answer would differ depending on the asset class in question. Among those which did provide a response, three issuers and one smaller CRA[289] noted that four years was an appropriate length in their view. However, two issuers and one CRA favoured longer periods such as 6-8 years, referring to the recently adopted rotation periods for audit companies.[290]

398. There was no consensus amongst respondents to the Call for Evidence as to the length of the two relevant periods. Given its lack of direct experience with the application of this provision, ESMA does not have sufficient evidence to evaluate their appropriateness.

6.1.1.3 The exemption provided in Article 6b(2)

399. The following subsection considers whether it would be appropriate to amend the exemption referred in the second subparagraph of Article 6b(2). This sub paragraph states that:

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[288] as noted in Section 3 above

[289] Issuer responses to question 22 of the Call for Evidence. CRA response to question 14 of the Call for Evidence.

[290] Issuer responses to question 22 of the Call for Evidence. CRA response to question 14 of the Call for Evidence.

'Where a credit rating agency enters into a contract for rating re-securitisations, it shall request that the issuer:

(a) determine the number of credit rating agencies which have a contractual relationship for the issuing of credit ratings on re-securitisations with underlying assets from the same originator;

(b) calculate the percentage of the total number of outstanding rated re-securitisations with underlying assets from the same originator for which each credit rating agency issues credit ratings.

Where at least four credit rating agencies each rate more than 10 % of the total number of outstanding rated re-securitisations, the limitations set out in paragraph 1 shall not apply.'

400. Article 6b(2) of the CRA Regulation requires that information about CRAs rating other re-securitisations with underlying assets from the same originator is to be provided by the issuer. According to the response submitted by the Association for Financial Markets in Europe (AFME), which represents a range of issuers, CRAs and investors, this is not a realistic proposition. They argue that:

'there generally will not be any connection between the issuer of the re-securitisation and any underlying originator. Considering that the originator itself may not even be aware of the fact that asset-backed securities backed by assets originated by it have been included in a re-securitisation, AFME considers it unlikely that the relevant information justifying an exemption under Article 6b(2) will be retrievable by the relevant parties. Furthermore, AFME questions whether the information could be assessed (by any party) in any event, given that re-securitisations may be undertaken on public or private basis.'

401. It is difficult to assess this argument and the usefulness of the exemption in Article 6b(2) of the CRA Regulation given the lack of available evidence. Indeed, most of the other respondents to the Call for Evidence did not express views on these issues due to their lack of experience of re-securitisations.

6.1.2 Respondents' views on the mandatory rotation provision and the potential extension of its scope

402. Since the entry into force of Article 6b of the CRA Regulation no new credit ratings have been assigned to re-securitisations issued in the EU so the provision has not yet been applied in practice. It is therefore not possible to analyse its impact on the problems of conflicts of interest, the lock-in effect and low competition which were identified by the legislator. This subsection presents the views of the three groups of respondents consulted through the Call for Evidence. However, it is important to note that these responses almost exclusively reflect the expected effect or impact of the mandatory rotation provision rather than its actual impact.

The Call for Evidence did not explicitly ask for respondents' views on the existing scope of the mandatory rotation provision, or their views on mandatory rotation more generally. However, 15 of the responses submitted gave a negative opinion of the mandatory rotation of CRAs as intended by Article 6b of the CRA Regulation. All of these responses also gave a negative view of mandatory rotation of CRAs more generally. Of the 62 responses received, two small CRAs and one issuer expressed support for the extension of the scope of Article 6b to other asset classes whereas 30 responses were opposed to any further extension. The remaining responses did not express a clear opinion, often citing the lack of experience of the current provision.

Table 5: Summary of responses to the Call for Evidence on Article 6b

Category of Respondent	View on Article 6b as currently formulated		Extending the scope of Article 6b	
	Opposed	In favour	Opposed	In favour
Issuers and issuer associations	8	0	18	1
Investors and investment associations	4	0	6	0
Credit Rating Agencies	3	0	6	2
TOTAL	15	0	30	3

Source: Issuer responses to question 23 of the Call for Evidence, Investor responses to question 22 of the Call for Evidence, CRA responses to question 14 of the Call for Evidence.

403. One corporate issuer expressed support for mandatory rotation, as it considers that it *'could improve competition between CRAs and therefore the quality of the services and that a four year period should be adequate'* to achieve these aims.[291] However, it noted that the extension to other asset classes should be conditional on the availability of an appropriate number of highly qualified CRAs. A CRA was in principle in favour of mandatory rotation, 'however, EU Authorities have to develop the framework and mechanism allowing small & new CRAs to be able to meet such a requirement.'[292] Another CRA also expressed support for mandatory rotation because changing CRAs could generate competition and transparency for the markets.[293]

404. The respondents that were not in favour of mandatory rotation gave four main reasons for their views, which are considered below:

- independence of the CRAs;
- time and costs imposed on CRAs as well as users;
- continuity of ratings; and
- competition between CRAs.

405. With regard to the independence of CRAs, a number of respondents questioned whether this issue constituted a real problem in this context. One organisation representing investors argued that the notion that *'CRAs would not able to keep an independent view on deals of an issuer or originator when they better know its organisation'* was based on *'unjustified assumptions'*.[294] According to this response, competition between CRAs as well as the use of internal control mechanisms were better means of mitigating potential conflicts of interest. An association of banks supported this view, stating that *'mandatory rotation of the primary analyst and Chinese walls between analysts and business development address[es] this problem adequately.'*[295] A corporate issuer argued that potential gains in terms of increased independence would never justify *'the additional costs and workloads'* associated

[291] Issuer response to question 23 of the Call for Evidence.
[292] CRA response to question 14 of the Call for Evidence.
[293] CRA response to question 14 of the Call for Evidence.
[294] Investor responses to question 21 of the Call for Evidence.
[295] Issuer responses to question 23 of the Call for Evidence

with implementing a mandatory rotation obligation in practice.[296] However, one small CRA stated that rotation stops analysts from becoming too close to their clients by helping them to maintain a neutral perspective.[297]

406. Another argument raised by several respondents concerned the time and cost of establishing business relationships and mutual trust with a new CRA. One corporate issuer stated that the existing provisions of the CRA Regulation regarding analyst rotation were *'already quite time consuming'* and that costs and time spent would increase further if they were forced to change CRAs, especially if they would need to switch to smaller CRAs.[298] This view was shared by another corporate issuer which stated that obtaining *'an initial rating is extremely time consuming and costs a lot'.*[299] A bank recognised that *'new analysts need a lot of time to understand the bank in detail'* [300] a view which was shared by a national association of banks. This association which noted that *'a change of analysts already 2 years after they have become acquainted with the bank would be highly inefficient and not necessarily increase the quality of the ratings.'* Another bank involved in the issuance of structured finance instruments stated that *'the amendment of documents and the on-boarding of a new counterparty are quite expensive processes which are currently not factored into the modelling of a securitisation'* and that changing CRA may lead to a review of the credit rating issued.[301]

407. This links to the third argument concerning the continuity of ratings. Many responses expressed concerns that mandatory rotation of CRAs could have a damaging effect on the consistency of assigned ratings and increase volatility in ratings due to differences in CRAs' methodologies and ratings scales rather than changing fundamentals.[302] This in turn could affect investors' ability to maintain a stable investment portfolio[303] and *'issuers' ability to plan the timing and pricing of their debt issuance'*.[304] More frequent credit rating changes and an associated increase in uncertainty and instability in European capital markets were also predicted as the likely effects of a mandatory rotation obligation by two large CRAs.[305] An association representing corporate treasurers emphasised the scope of the potential impact of a loss in rating consistency, as it is not only important to the rated firm but also *'to those exposed to its credit – everyone that deals with the firm and communities within which it has important activities'*.[306] One association noted that in the event that a mandatory rotation obligation were to be implemented, it should be made a requirement for all market participants immediately, otherwise the markets' perception of changing CRA, and potentially rating notch, could be very damaging.[307]

408. The concern regarding rating consistency and volatility is clear for corporate ratings. However, a similar concern could be raised for SFIs where rotation is required during the lifetime of a securitisation. A bank noted that a lack of rating stability *'will ultimately impact end investors who may no longer be able to hold the*

[296] Issuer response to question 23 of the Call for Evidence.
[297] CRA response to question 15 of the Call for Evidence.
[298] Issuer response to question 21 of the Call for Evidence.
[299] Issuer response to question 21 of the Call for Evidence.
[300] Issuer response to question 21 of the Call for Evidence.
[301] Issuer response to question 23 of the Call for Evidence.
[302] Issuer responses to question 23 of the Call for Evidence, Investor response to question 21 of the Call for Evidence, Investor response to question 23 of the Call for Evidence, CRA response to question 14 of the Call for Evidence.
[303] Investor response to question 21 of the Call for Evidence and CRA response to question 13 of the Call for Evidence.
[304] Issuer response to question 23 of the Call for Evidence.
[305] CRA responses to questions 13 and 15 of the Call for Evidence.
[306] Issuer response to question 23 of the Call for Evidence.
[307] Issuer response to question 22 of the Call for Evidence.

instrument under their current risk appetite or specific CRA driven mandates.' This uncertainty is, according to the same bank, '*likely to undermine investor confidence in investing in such instruments and CRAs' ability to provide sound analysis of SFIs.''*[308]

409. However, ESMA notes that these concerns are mitigated by Article 6b(4) of the CRA Regulation which provides that *'where a credit rating of a re-securitisation is issued before the end of the maximum duration of the contractual relationship…a credit rating agency may continue to monitor and update those credit ratings on a solicited basis for the duration of the re-securitisation'*.

410. The fourth issue which was broadly raised concerns the impact of mandatory rotation on competition between CRAs. Several respondents did not expect mandatory rotation of CRAs to have any positive impact on competition. According to an association of corporate treasurers the measure is unlikely to have a positive impact on competition as it is based on the false *'assumption that credit ratings are a commoditised product'* whereas in reality '*methodologies and experience may differ between CRAs.'*[309] The variety of methodologies used by CRAs was seen as beneficial by this respondent, which cautioned that the adoption of one methodology by all CRAs would reduce the information contained in, and the value of, credit ratings.

411. Some respondents expected mandatory rotation of CRAs to result in higher prices and a reduction in the quality of service.[310] One CRA argued that mandatory rotation of CRAs would provide a *'disincentive to compete on the basis of track record and reputation for analytical quality or price.'*[311] Some issuers of SFIs supported this argument on the basis of the *'relatively short mandatory rotation period.'*[312] Furthermore, one association representing corporate treasurers did *'not believe that rotation would enhance competition within the CRA industry, because issuers are only willing to pay for ratings that are recognised internationally'*[313] in any case.

6.1.2.1 Handover file

412. There was broad consensus among the issuers and CRAs of different sizes that responded to the Call for Evidence that requiring the CRA rotating-out to provide a handover file to the incoming CRA would not be likely to help achieve the objectives of mandatory rotation in the CRA industry[314] and could be potentially harmful, especially in the event that the provision were to be extended to other asset classes. Very few respondents expressed positive views about the idea. Two issuers thought that a hand-over file might partly off-set the additional costs of mandatory rotation, although one of these made clear that it would likely be an ineffective and insufficient measure.[315] Most respondents viewed the notion of a hand-over file negatively, for three main reasons.

413. Firstly, a handover file could compromise the independence of the incoming CRA[316] by making it difficult for them to justify a departure from the credit rating

[308] Issuer response to question 22 of the Call for Evidence.
[309] Issuer response to question 23 of the Call for Evidence.
[310] Issuer response to question 23 of the Call for Evidence.
[311] CRA response to question 15 of the Call for Evidence.
[312] Issuer response to question 23 of the Call for Evidence.
[313] Issuer response to question 23 of the Call for Evidence. See also the concerns identified in Section 5 above.
[314] CRA responses to question 15 of the Call for Evidence.
[315] Issuer responses to question 23 of the Call for Evidence.
[316] Issuer response to question 23 of the Call for Evidence.

issued by the previous CRA. It could create positive and negative prejudices in the analysis of the incoming CRA, which could bias its conclusions.[317] Furthermore, this could create leverage for the issuer to challenge a rating decision provided by the incoming CRA. However, having the means to challenge the decision of the incoming CRA in this way was viewed positively by one issuer as it would, in their view, help to mitigate the negative impact of mandatory rotation on their business.[318]

414. Secondly, a mandatory handover file could risk compromising confidentiality agreements in place between the CRA and the issuer[319] as well as the intellectual property rights of the outgoing CRA.[320] One issuer proposed that, as an alternative, the issuer could establish a portal to make information available to all CRAs appointed.[321]

415. Thirdly, given differences in methodology and templates, the hand-over file may ultimately be of limited help to the incoming CRA. There would, therefore, be a risk of wasting time and resources creating a file which would add little value.[322] The flip-side of this argument is the risk that the incoming CRA relies excessively on the handover file, which would compromise the objective of obtaining a *'fresh review'* from the incoming CRA.[323]

416. For these reasons it appears that a hand-over file would be unlikely to off-set the continuity challenges raised by the use of mandatory rotation provisions in the CRA industry.

6.1.3 Overall assessment

417. In hindsight, it is clear that the markets for re-securitisations were not good sample markets in which to test the effect of a mandatory rotation provision for CRAs as they have not revived since the financial crisis. This means that Article 6b of the CRA Regulation has not yet been used in practice and so ESMA has not gained any supervisory experience of this provision. However, responses to the Call for Evidence from issuers, investors and CRAs clearly show broad resistance to the concept of mandatory rotation of CRAs, both as regards its application to re-securitisations with underlying assets from the same originator as well as to rated entities and instruments more generally.

418. The proposal to introduce hand-over files faces a number of practical problems concerning confidentiality and does not adequately recognise the differences between credit ratings assigned by different CRAs, including differences in methodologies and templates. Requiring CRAs to provide handover files also appears to run contrary to the objective of improving the independence of CRAs and stimulating competition, as it could provide CRAs with an unnecessary level of transparency into their competitors' rating practices.

419. At this stage there is no information on which to assess the appropriateness of the length of the contractual limits set out in Article 6b(1) and (3) of the CRA Regulation. The same applies to the exemption in Article 6b(2) of the Regulation, which can be

[317] Issuer response to question 23 of the Call for Evidence.
[318] Issuer response to question 23 of the Call for Evidence.
[319] Issuer responses to question 23 of the Call for Evidence.
[320] CRA response to question 15 of the Call for Evidence.
[321] Issuer response to question 23 of the Call for Evidence.
[322] Issuer response to question 23 of the Call for Evidence.
[323] Investor response to question 23 of the Call of Evidence.

used in cases where at least four CRAs each rate more than 10% of the total number of outstanding rated re-securitisations. It is possible that this exemption might not be used in practice as, according to one association, it would be difficult to collect and assess the information necessary to trigger its application.[324]

420. Finally, the choice of CRAs rating SFIs and re-securitisations is not sufficient to comply with the requirements set out in Article 6b and Article 8c of the CRA Regulation. Several respondents questioned whether there were a sufficient number of qualified and specialised CRAs which might be willing to issue credit ratings in this area in the event that the markets for re-securitisations were to be revived. ESMA will continue to monitor the development of the markets for SFIs and the use of Article 6b of the CRA Regulation in future.

6.2 Disclosure of information about Structured Finance Instruments

421. The following section assesses Article 8b of the CRA Regulation, without prejudice to any future legislative proposals which might be made by the Commission regarding securitisation. Article 8b of the CRA Regulation requires ESMA to establish a platform on which issuers, originators and sponsors established in the EU will publish information on the credit quality and performance of the underlying assets of SFIs which will be made available through a publically accessible website. This information should include the structure of the securitisation transaction, the cash flows and any collateral supporting a securitisation exposure as well as any information that is necessary to conduct comprehensive and well-informed stress tests on the cash flows and collateral values supporting the underlying exposures.

422. This requirement was introduced as a part of the 2013 amendments to the CRA Regulation. The aim of the platform would be to provide investors with sufficient information on SFIs to be able to make an informed assessment of their creditworthiness. Recital 30 to the 2013 amendments to the CRA Regulation states that investors should be provided with information on the underlying assets as the risks associated with SFIs depend to a large extent on the quality and performance of the underlying assets. Such disclosures would be expected to: *'reduce investors' dependence on credit ratings'* and reinforce competition between CRAs as they *'could lead to an increase in the number of unsolicited credit ratings'* issued.[325]

423. The following subsections consider the requirements of Article 8b and examine *'whether there is a need to extend the scope of the obligations referred to in Article 8b to include any other financial credit products'* as requested by Article 39(5) the CRA Regulation.

424. The following subsection assesses Article 8b of the CRA Regulation on the basis of responses to the Call for Evidence. In the Call for Evidence, investors, issuers and CRAs were asked whether the reporting requirements under Article 8b were sufficient or should be extended to other asset classes. In addition, issuers were asked to provide an estimate of the costs of compliance with Article 8b, both as it is

[324] Issuer response to question 16 of the Call for Evidence.
[325] Recital 30 of Regulation 462/2013 referred to in footnote 2 above.

currently formulated and in the event that it were to be extended to other instruments.[326]

425. The response rate to the questions regarding Article 8b of the CRA Regulation was low. This may be because the provision has not yet been implemented, or due to the fact that many of the organisations that responded to the Call for Evidence had no experience of the provision, for example because they did not issue or invest in SFIs. The general view from the responses received was mixed. Whereas most issuers and investors were sceptical about the potential benefits of further disclosure requirements, the view among the CRAs was slightly more favourable.

426. The arguments presented in favour of the extension of disclosure requirements differed depending on the specific asset classes. For this reason, covered bonds and other categories such as corporates, financial institutions and sovereigns are considered separately in the following paragraphs.[327]

427. Concerning covered bonds, the views of the respondents were mixed. One public institution argued that it would be beneficial for investors if all covered bonds, including structured covered bonds, were subject to the same reporting requirements as SFIs because *'not only would this result in greater transparency of this asset class, but would also create a level playing in terms of regulatory compliance between ABS and covered bonds.'*[328] One small CRA stated that instruments which do not qualify as SFIs and instruments for which the information about the terms of the issuance and the quality of available collateral is not publicly available (such as covered bonds) could potentially benefit from extended disclosure requirements given that there is currently insufficient data publicly available to rate such assets.[329] Investors responding to the Call for Evidence did not provide any specific comments about covered bonds.

428. A national association of banks and an association of covered bond issuers were strongly opposed to extending the scope of Article 8b of the CRA Regulation to covered bonds. They argued that costs would increase *'dramatically'*, if the disclosure requirements provided for in the existing Regulatory Technical Standards[330] would be extended to *'huge dynamic cover pools'*.[331] An association of covered bond issuers noted that cover pools *'evolve over time'* and that some pools might contain in excess of 600,000 loans. These two respondents stated that the limited benefits would not justify the additional reporting costs. They noted that covered bonds are first of all bank bonds, so any investor has a dual recourse claim against the issuer, and would also have access to the cover pool of assets in case of issuer default. Both stakeholders agreed that transparency beyond SFIs should be dealt with through other sectoral regulation, for instance within the framework of simple, standardised and transparent securitisations or through a potential harmonisation of the requirements for covered bonds. In this context, the association of covered bond issuers highlighted *'the Covered Bond Label initiative',* which is an

[326] See Issuer questions 19-20 of the Call for Evidence, Investor question 20 of the Call for Evidence and CRA question 9 of the Call for Evidence referred to in footnote 5 above
[327] The specific reporting requirements for both ABCPs and private and bilateral securitisations are subject to ongoing work within ESMA and will not be assessed within the framework of this Technical Advice.
[328] Issuer response to question 19 of the Call for Evidence. However, ESMA notes that this respondent does not issue covered bonds and so answered this particular question from an investor perspective.
[329] CRA response to question 9 of the Call for Evidence.
[330] Commission Delegated Regulation (EU) 2015/3 of 30 September 2014 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards on disclosure requirements for structured finance instruments, *OJ L 2, 6.1.2015, p. 57–119, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32015R0003, last accessed 26.08.2015.*
[331] Issuer responses to question 19 of the Call for Evidence.

industry-led initiative that aims to provide further transparency regarding covered bonds.

429. The potential extension of the disclosure requirements in Article 8b of the CRA Regulation to other instruments was mainly raised by CRAs. Three small CRAs agreed that the extension of transparency requirements to those corporate bonds for which information is not otherwise readily available could help to create a level playing field for market participants and new entrants and could lead to an increase in the number of unsolicited ratings.[332] Financial institutions are already reporting substantial amounts of information, for example to FINREP,[333] but having such information centrally available in a standardised format was seen as beneficial.

430. One large CRA[334] suggested a range of enhancements in disclosure requirements, however, not necessarily within the scope of the CRA Regulation. These included:

- Listing debt securities by issue with key features (maturity, coupon, covenants);
- Disclosure of distributable reserves at least semi-annually; and
- Unconsolidated financial reporting by parent companies and all of its major debt issuing subsidiaries in one place.

431. The arguments made by stakeholders against extending the requirements of Article 8b of the CRA Regulation, generally pointed to the adequacy of the disclosures for other asset classes arising from legislation, such as Solvency II,[335] as well as the Prospectus and Transparency Directives, including periodically audited accounts, annual accounts, management reports, investor presentations and related information.[336]

432. Furthermore, a number of CRAs[337] highlighted the issue of compliance costs in extending any reporting requirements and one CRA even suggested that Article 8b would not deliver benefits sufficient to warrant the significant implementation costs for smaller CRAs.[338] Concerns regarding compliance costs were also raised by one issuer which provided cost estimates for compliance with the existing scope of Article 8b of the CRA Regulation, stating that it could cost in the region of £250,000 to £500,000 initially, in addition to recurring costs of around £50,000 annually. On this basis the issuer was concerned about further extensions of these disclosure requirements.[339] Two issuers stressed that information already provided by information services providers should not be duplicated.[340]

433. As Article 8b of the CRA Regulation has not yet been implemented in practice, it is premature to draw conclusions about its costs and benefits and the appropriate scope of the reporting requirements. Responses to the Call for Evidence indicate that views are mixed regarding the extension of disclosure requirements to covered bonds. Several respondents called for enhancements to financial disclosure

[332] CRA responses to question 9 of the Call for Evidence.
[333] Financial Reporting (FINREP) is an EU-wide supervisory reporting framework for Financial Reporting which covers Financial Reporting for supervisory purposes based on International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS), as endorsed by the EU.
[334] CRA response to question 9 of the Call for Evidence.
[335] CRA response to question 9 of the Call for Evidence.
[336] CRA response to question 9 of the Call for Evidence.
[337] CRA responses to question 9 of the Call for Evidence.
[338] CRA responses to question 9 of the Call for Evidence.
[339] Issuer responses to question 20 of the Call for Evidence.
[340] Issuer response to question 19 of the Call for Evidence.

requirements more broadly and highlighted the need for consistency across EU legislation. Some issuers and CRAs stressed the need for proportionality in the inclusion of new disclosure requirements, taking into account existing obligations.

434. As stated in the Joint Committee of the ESAs' Report on Securitisation,[341] any amendment to existing disclosure requirements should be considered in light of further work on the transparency and due diligence requirements associated with SFIs and similar products. Any amendments to transparency requirements should be implemented across all comparable market segments or instruments with comparable features for issuers and investors so as not to make it more onerous or costly to issue some instruments as compared to others.

6.3 Multiple credit ratings for SFIs

435. Article 8c of the CRA Regulation states that *'where an issuer or a related third party intends to solicit a credit rating of a structured finance instrument, it shall appoint at least two credit rating agencies to provide credit ratings independently of each other.'*

436. The background to this provision is provided in Recital 28 of the 2013 amendments to the CRA Regulation which notes that *'due to the complexity of structured finance instruments, credit rating agencies have not always succeeded in ensuring a sufficiently high quality of credit ratings issued on such instruments.'* The provision was therefore introduced with two purposes in mind:

- Restoring investor confidence in the markets for SFIs; and
- Reducing over-reliance on a single credit rating.

437. The impact of Article 8c in conjunction with Article 6b of the CRA Regulation is discussed in Section 6.1 above. The following subsections assess the impact of Article 8c as a stand-alone provision and Article 8c in conjunction with Article 8d of the CRA Regulation. The implementation of Article 8d was considered in Section 5 above.

6.3.1 Stand-alone impact

438. The following subsection assesses Article 8c on the basis of feedback provided by respondents to the Call for Evidence. The Call for Evidence asked issuers and CRAs about the perceived impact of Articles 8c and 8d of the CRA Regulation on their business whereas investors were asked what impact multiple credit ratings have on their investment decisions. In addition, investors and CRAs were asked whether the obligation to obtain at least two credit ratings for SFIs should be extended to other asset classes.[342]

439. The majority of respondents agreed as a stand-alone requirement Article 8c of the CRA Regulation has had very little or no impact. According to many respondents, it is already established practice in the industry to have SFIs rated by more than one

[341] See paragraph 8 of JC2015/22, Joint Committee Report on Securitisation of 12 May 2015, referred to in footnote 257 above.
[342] For the full outline and presentation of the questions asked see the Call for Evidence referred to in footnote 5 above, at question 10 of the Call for Evidence for issuers, questions 16-18 of the Call for Evidence for investors and questions 10-12 of the Call for Evidence for CRAs.

CRA.[343] One issuer highlighted in this context that obtaining a double rating is a requirement for SFIs to be eligible for ECB refinancing.[344] Only one issuer stated that Article 8c has led to the solicitation of an additional rating, at an estimated cost of €70,000.[345] Another issuer raised concerns about the small number of CRAs that rate SFIs and in particular the impact if one CRA were to withdraw from rating a particular asset class.[346]

440. Although some investors found it useful to have multiple ratings, none of the investors that responded supported a mandatory requirement to solicit a set number of ratings for SFIs or other financial instruments. Such prescriptions were seen by some investors to potentially lead to over-reliance on ratings. Indeed, one association of investors stressed that issuers should not be required to solicit a second rating unless this can be justified commercially.[347]

441. Among the CRAs with experience of rating SFIs, Article 8c of the CRA Regulation was seen to have had a limited impact to date. Only one CRA reported an increase in its business in this category of ratings. The ECAF used by the ECB, which only recognises four large CRAs, as well as the delays in producing the ECAI mapping required by the Capital Requirements Directive and Solvency II[348] are, according to one CRA, major reasons why Article 8c of the CRA Regulation has not had a greater positive impact on smaller CRAs.[349] Some smaller CRAs favoured the extension of the requirement in Article 8c of the CRA Regulation to other rating categories, such as corporate bonds, whereas this was opposed by some larger CRAs.[350]

6.3.2 Impact in conjunction with Article 8d of the CRA Regulation

442. The responses to the Call for Evidence indicated that the impact of Article 8c was similar, when considered alone or in conjunction with Article 8d of the CRA Regulation. The majority of issuers stated that compliance with the current documentation requirements under Article 8d is not very costly but that awareness of these requirements in the industry is limited.[351] One issuer pointed out that the cost of documenting the decision of a CRA is negligible, but that the costs of actually studying and assessing the methodology of a new CRA can be substantial.[352] This view was shared by another issuer which stressed the considerable costs of taking on a smaller CRA, in cases where the issuer needs to help them understand a business or sector of which it has no previous experience.[353] A third issuer questioned why it should be required to note its choice of two CRAs, as this is a course of action that is both *'logical and safe'*.[354]

443. Some investors expressed openness, in principle, to considering ratings from smaller CRAs.[355] Other investors stated clearly that they only took into account ratings from the largest three CRAs operating globally and that in order for this to

[343] Investor responses to question 16 of the Call for Evidence and Issuer responses to question 10 of the Call of Evidence.
[344] Issuer response to question 10 of the Call of Evidence.
[345] Issuer response to question 10 of the Call of Evidence.
[346] Issuer response to question 10 of the Call of Evidence.
[347] Investor response to question 17 of the Call of Evidence.
[348] As referred to in Section 5 above.
[349] CRA response to question 10 of the Call of Evidence.
[350] CRA responses to question 11 of the Call of Evidence.
[351] As explained in Section 5 above.
[352] Issuer response to question 10 of the Call of Evidence.
[353] Issuer response to question 10 of the Call of Evidence.
[354] Issuer response to question 10 of the Call of Evidence.
[355] Investor responses to question 18 of the Call of Evidence.

change any new CRA would need to be able to demonstrate their reputation and track record.[356] One association of investors also highlighted their reluctance to use ratings from smaller CRAs and new entrants on the basis of the perceived quality difference between these CRAs and the largest CRAs operating globally.[357]

444. Most CRAs confirmed that the requirement to consider using a CRA with less than a 10% market share in cases where two or more CRAs are to be appointed had had no real impact on their business to date, as noted in Section 5 above.[358] The only CRA to report that this provision had had a positive impact was DBRS, which despite being a well-established CRA with a considerable share of supply of credit ratings issued in some categories in some Member States, has an overall market share of less than 10% according to the calculations carried out by ESMA for the purposes of Article 8d.[359] As the growth experienced by DBRS in the years before 2013 broadly matches the pace of growth over the last two years, it does not seem that its growth can be solely attributed to Articles 8c and 8d of the CRA Regulation.[360]

445. As noted in Section 5 above, according to some larger CRAs, competition within the CRA industry has increased.[361] However, this view was not shared by many smaller CRAs and new entrants, which suggests that it is too soon to evaluate the impact of Articles 8c and 8d on competition between CRAs. Most of the CRAs that responded to the Call for Evidence noted the very limited awareness of these provisions amongst market participants.[362] Smaller CRAs and new entrants generally called for SCAs to promote and enforce these provisions, arguing that they could result in increased competition which would benefit the CRA industry.[363] Two CRAs stated that detailed guidelines would help raise awareness of the provision and facilitate compliance.[364]

6.4 Overall assessment of provisions relating to Structured Finance Instruments

446. This section provided an assessment of the provisions which were introduced as a part of the 2013 amendments to the CRA Regulation to address specific problems related to the EU markets for credit ratings of SFIs. In particular the mandatory rotation requirement regarding re-securitisations, the disclosure requirement for SFIs and the requirement to obtain multiple ratings for SFIs were considered.

447. It is not possible to fully assess the impact of Article 6b of the CRA Regulation as it applies to a special subset of SFIs which are not widely favoured by market participants at present. Despite the lack of experience with the application of Article 6b, respondents to the Call for Evidence were generally sceptical about the merits of the provision as well as about the use of mandatory rotation in the CRA industry more generally. A number of practical obstacles were identified regarding the proposal to introduce hand-over files. Finally, it is clear that there is not currently a sufficient choice of CRAs issuing ratings on re-securitisations in order to comply with

[356] Investor responses to questions 16-18 of the Call of Evidence.
[357] Investor response to question 18 of the Call of Evidence.
[358] CRA responses to question 10 of the Call of Evidence.
[359] See ESMA2014/1583 Credit Rating Agencies Market Share Calculations for the purposes of Article 8d of the CRA Regulation, 22 December 2014, referred to in footnote 77 above.
[360] See figure 9 in Section 3 above.
[361] CRA responses to question 10 of the Call of Evidence.
[362] CRA responses to question 10 of the Call of Evidence.
[363] CRA responses to question 10 of the Call of Evidence.
[364] CRA responses to questions 10 and 11 of the Call of Evidence.

the requirements to obtain at least two credit ratings in cases where the mandatory rotation obligation might apply.

448. As Article 8b of the CRA Regulation has not yet been implemented in practice it is premature to draw conclusions about its costs and benefits and the appropriate scope of the reporting requirements. Respondents' views concerning the extension of disclosure requirements to covered bonds were generally mixed. Several respondents called for enhancements to financial disclosure requirements more broadly, and for consistency across EU legislation.

449. Article 8c of the CRA Regulation has had limited impact as a stand-alone provision as the requirement to obtain multiple credit ratings for SFIs already represents market practice to a large extent. The impact of Article 8c in conjunction with Article 8d has also been limited according to the responses received to the Call for Evidence. Many respondents felt that this was due to a lack of awareness of these provisions among market participants. Smaller CRAs and new market entrants called for SCAs to promote and enforce Articles 8c and 8d of the CRA Regulation.

450. ESMA notes that it is too early to carry out a full evaluation of these provisions and stresses the importance of conducting detailed impact assessments which take into account the specificities of the markets for credit ratings of different asset classes before considering any further initiatives in this area.

7 Conclusion

7.1 Future Developments

451. ESMA has been the EU's direct supervisor of CRAs since 2011. It has gained considerable experience during this time and now aims to use this experience to develop and refine its approach to supervision as outlined in ESMA's strategic orientation for the period 2016-2020.[365]

452. ESMA aims to achieve these objectives by increasing its monitoring capabilities and making full use of all of the tools in its supervisory tool box; from market monitoring to the issue of guidelines and opinions.

453. ESMA is currently implementing the ERP and fees reporting module which will give it greater visibility of changes in market dynamics and CRAs' behaviour in the future. ESMA aims to complement this by seeking to ensure the uniform interpretation of the CRA Regulation and uniform reporting by CRAs through the issue of guidance as well as the increased use of its enforcement powers. ESMA will also continue to encourage supervisory convergence through its work with the SCAs responsible for the implementation of Articles 8c and 8d of the CRA Regulation.

454. ESMA calls on the Commission to support it in its aims to further increase its supervisory effectiveness by supporting ESMA's future projects to help clarify the interpretation and application of the CRA Regulation as well as by considering the areas for suggested regulatory change highlighted in the Technical Advice. ESMA invites the Commission to draw on its expertise in the development of future initiatives which may impact on credit ratings, for example in the context of the creation of a Capital Markets Union.

455. In this respect, ESMA highlights that in order to support the objectives of creating a Capital Markets Union, the diversity of the existing markets for credit ratings of different entities and financial instruments in the EU needs to be recognised. Given the specificity of individual credit ratings, completing the internal market does not necessarily require the creation of one single market for credit ratings, but rather the ability for EU businesses to access high quality credit ratings from a range of providers at affordable prices, irrespective of the EU Member State in which they wish to operate.

456. In order to achieve this, smaller CRAs and new entrants need to be able to demonstrate the quality of their credit ratings so that they can compete to be used by market participants in their future transactions. ESMA notes that the mapping initiatives currently being carried out at EU level may assist in this process and will continue to monitor the development and implementation of these initiatives and their impact on competition between CRAs going forward.

[365] ESMA 2015/935, ESMA Strategic Orientation 2016-2020, 15 June 2015, referred to in footnote 180 above.

7.2 Advice to the Commission

457. This final subsection summarises how the above findings address each of the questions set out in Articles 39(4) and 39(5) of the CRA Regulation.

458. In answer to the questions regarding conflicts of interest and the use of existing and alternative remuneration models set out in Article 39(5)(b) and (d) of the CRA Regulation, ESMA finds that:

a) The CRA Regulation does not prescribe the use of any particular remuneration model. This approach allows CRAs to use investor-pays models and to offer subscription services alongside the issuer-pays model. This flexibility is welcomed by market participants and should be retained.

b) The CRA Regulation includes a number of provisions aimed to help manage the conflicts of interest inherent in the CRA industry by increasing transparency and the independence of CRAs. This has been achieved through the use of operational requirements and disclosures by CRAs set out in Articles 6 and 7 and Annex I of the CRA Regulation.

c) The policies and procedures required by these provisions are still bedding in, particularly amongst smaller CRAs and new entrants. However, at this stage, CRA Regulation already appears to have had a positive impact on the governance and operation of CRAs overall. The broad requirements of Articles 6 and 7 have allowed ESMA to be flexible in its approach to supervision and the increased transparency required of CRAs has been welcomed by market participants as increasing the information available about the quality of credit ratings issued by CRAs.

d) Nevertheless, it appears that providing additional clarity as to some of the requirements of the CRA Regulation, for example regarding internal control mechanisms and risk assessment procedures, could further enhance the effectiveness of ESMA's supervision of CRAs. ESMA would also benefit from having the ability to be more proactive in ensuring the appointment of appropriate INEDs after CRAs have been registered.

e) There seems to be a lack of clarity about ESMA's role with regards to information disclosed by CRAs and CRAs' methodologies. ESMA wishes to highlight that whilst it will regularly examine CRAs' compliance with Article 8(3) of the CRA Regulation, it does not have, nor should it have, the power to approve or interfere with CRAs' methodologies.

f) Finally, ESMA finds that the exemptions available to smaller CRAs under Article 6(3) of the CRA Regulation do not have a negative impact on the independence of the credit rating process in these CRAs. ESMA would welcome further quantitative measures to align the criteria for exemption under the CRA Regulation with other EU financial services legislation, such as the EU Accounting Directive which considers balance sheet size, net turnover and average number of employees.

459. ESMA has provided its views on the situation in the markets for credit ratings, by considering how individual markets and overall market dynamics have changed between 2009 and 2014. In answer to the specific questions set out in Article 39(5)(h) regarding market concentration levels, the risks arising from high concentration and the impact on financial stability, ESMA finds that:

a) There are likely to be separate product and geographic markets for different credit ratings as they are highly individualised products developed using different methodologies which are not easily substitutable for each other.

b) Overall, the individual markets for different categories of credit ratings at international and Member State level may be seen as platform markets which bring together different customer groups. These markets are often characterised by the presence of only a few firms so they might be quite highly concentrated and market entry might not be immediate due to the presence of barriers to entry.

c) The concentrated nature of the markets for credit ratings suggests that the largest CRAs operating globally may be able to exercise market power. This may enable them to raise prices above competitive levels or to restrict the choice or quality of products and services available unless new entrants are able to enter the market to provide and challenge them.

d) Platform markets are often quite concentrated and may have a tendency to tip towards monopoly. In the CRA industry, this may be because issuers wish to use only those platforms which are recognised by the investors they seek to target and investors only wish to use platforms offering ratings of those issuers and instruments in which they want to invest. In this way, the need to establish a network of issuers and investors on both sides of their platform is a general barrier to entry into the CRA industry.

e) In addition, there are a number of other general barriers to entry which arise from the expertise needed to provide credit ratings and the regulation of the industry. These barriers are necessary in order to ensure the issue of high quality independent credit ratings. Indeed, the standards imposed by the CRA Regulation are intended to prevent CRAs from reducing the quality of their credit ratings in order to win business, and so seek to avoid the recurrence of events which harmed issuers and users of SFI ratings during the financial crisis.

f) The level of interdependence between CRAs may provide scope for CRAs to observe each other's behaviour and to act in similar ways, for example by reaching similar opinions about the creditworthiness of entities and instruments within a similar timescale. This may create risks to financial stability, for example where a number of CRAs downgrade certain financial institutions or sovereign issuers at or around the same time. These risks are regularly evaluated by ESMA through its on-going market monitoring.

g) In theory, measures to increase transparency in the CRA Regulation may make it easier for CRAs to coordinate their behaviour to the detriment of issuers, investors and other users of credit ratings, for example by limiting product and service choice, not investing in innovation or by charging high fees. However, responses to the Call for Evidence did not provide a clear picture of the practical impact of increased transparency on competition between CRAs. The potential effects of transparency in these markets may therefore merit further study.

460. In answer to the questions in Article 39(5)(e) of the CRA Regulation regarding the need for and appropriateness of additional measures to foster and promote competition against the background of the evolution of the structure of the sector, ESMA finds that:

a) The impact of the provisions of the CRA Regulation as amended on competition between CRAs is hard to assess. However, in general terms, it appears that CRAs now have greater visibility overall, which may be attributed to the registration process, to ESMA's enforcement work or to publications such as the list of registered and certified CRAs published pursuant to Article 8d, databases such as CEREP and CRAs' public disclosures, for example of their methodologies and their transparency reports. The introduction of the ERP should also help to give CRAs greater visibility.

b) However, some of the measures designed to stimulate visibility of smaller CRAs and new entrants, such as the ERP, are not available to CRAs who do not use the issuer-pays model because of the specificities of these business models.

c) ESMA's experience to date suggests that the impact of its enforcement powers would be increased if all the requirements of the CRA Regulation were to have a corresponding infringement and if ESMA's ability to impose fines could be tailored to have a more dissuasive effect, by better reflecting the turnover of the CRAs operating in the EU.

d) It is too soon to conclude on the overall effect of increased visibility on competition between CRAs, but it appears that smaller CRAs and new entrants are not yet issuing a significant number of credit ratings in all asset classes or geographic markets within the EU.

e) From the share of supply data presented it appears that a number of different CRAs hold strong positions in particular categories of credit ratings in individual Member States. This may indicate that they are able to exercise significant market power, especially in those categories where issuers frequently obtain two or three credit ratings.

f) The high fees and frequent fee increases charged by the largest CRAs operating globally for credit ratings services, research and data licences also suggest that these CRAs are able to exercise market power. European businesses could be harmed if CRAs use their market power to restrict the number of credit ratings being produced or to price some issuers and investors out of the markets for credit ratings and related data products and services.

g) ESMA is committed to making full use of its regulatory powers to address these concerns. ESMA believes that its supervisory effectiveness will be enhanced through its on-going work to clarify the definition of ancillary services in the CRA Regulation. ESMA's supervisory effectiveness would be further enhanced by the introduction of an infringement which mirrors Annex I Section B 3c of the CRA Regulation regarding the level of fees charged by CRAs.

h) It is not currently possible to assess the impact of Article 8d of the CRA Regulation as it has not yet been fully implemented and enforced at national level. This is in part due to the lack of clarity in the CRA Regulation about the scope of issuers to which the obligation applies and how the requirements to consider and document should be interpreted. ESMA continues to work with the Member States to encourage the development of a common approach to the supervision of Article 8d and is considering whether guidance needs to be provided to SCAs or issuers at Member State or EU level.

i) ESMA is also concerned that Article 8d of the CRA Regulation may not be achieving its aim of stimulating competition as the market share calculation it provides for is very broad. The calculation of CRAs' market shares by revenues or share of supply in the major categories of credit ratings issued at Member State level could be of greater value to issuers and investors in assessing CRAs' experience. Adopting a more granular approach would also avoid the unintended consequences associated with the current formulation, whereby a CRA holding a strong position in an asset class in one Member State can be appointed to provide ratings in that asset class in that Member State pursuant to Article 8d of the CRA Regulation as it has an overall market share of less than 10%.

j) Smaller CRAs and new entrants have reported that regulatory and contractual barriers are making it harder for them to develop their business through the issue of solicited credit ratings. ESMA notes that the mapping initiatives currently being carried out at EU level may assist in this process and will continue to monitor the development and implementation of these initiatives and their impact on competition between CRAs going forward.

461. In answer to the questions regarding the situation in the markets for credit ratings on SFIs and in particular the markets for credit ratings on re-securitisations, ESMA has considered the evolution of these markets in general terms. In response to the specific questions in Article 39(4)(a) to (c) and Article 39(5)(a) and (c) of the CRA Regulation ESMA finds that:

a) Article 6b of the CRA Regulation has not been used in practice and so it is not currently possible to assess its effectiveness. Market participants are sceptical about the usefulness of the provision as it relates to re-securitisations as well as about the merits of the mandatory rotation of CRAs in general.

b) On the face of it, it does not appear that there is sufficient choice of CRAs rating different asset classes for a rotation provision for re-securitisations to work effectively in practice and comply with the requirements of Article 8c of the CRA Regulation for issuers to obtain dual ratings for SFIs.

c) It does not appear that requiring rotating CRAs to provide hand-over files would improve the effectiveness of a mandatory rotation provision as this could raise concerns about the independence of CRAs. Furthermore, this increased insight into CRAs' rating practices would not help to stimulate competition between CRAs.

d) As Article 8b of the CRA Regulation disclosures relating to SFIs has not been implemented in practice it is premature to consider whether the scope of the reporting requirements should be extended. ESMA notes that any amendment to existing disclosure requirements should be considered in light of further work on the transparency and due diligence requirements for SFIs and similar products. Any such amendments should be introduced across all comparable market segments or instruments for all issuers and investors so as not to make it significantly more costly or onerous to issue some asset classes than others.

e) Article 8c of the CRA Regulation as a stand-alone provision appears to have had only a very limited impact to date as it mirrors existing market practice for seeking ratings of SFIs. The impact of Article 8c in conjunction with Article 8d of the CRA Regulation also appears to be limited due to a lack of awareness of the provision among market participants.

f) Before considering any further initiatives in this area, ESMA stresses the importance of carrying out detailed impact assessments which take into account the specificities of the markets for credit ratings of different asset classes.

462. Overall, the Technical Advice concludes that the CRA Regulation already appears to have had a positive impact on the governance and operation of CRAs overall. However, as it is too soon to determine what impact the Regulation has had with regard to a number of the specific points raised in Articles 39(4) and 39(5) of the CRA Regulation, it is therefore important to wait and see how the markets develop in response to the implementation of the CRA Regulation before adopting further measures.

463. This assessment should be revisited by ESMA within the next 3-5 years depending on changes in market dynamics. In light of the concerns raised in the Technical Advice about their effectiveness, ESMA will, in particular keep the following provisions under review:

a) Article 6 and Annex I regarding the use of disclosures to mitigate conflicts of interest;
b) Articles 6b regarding mandatory rotation;
c) Article 8d regarding the requirement to consider using CRAs with less than a 10% market share; and
d) Annex I Section B 3c regarding fees charged by CRAs for credit ratings and ancillary services.

8 Annexes

8.1 Annex I: Mandate to provide Technical Advice

1. Article 39(5) of the CRA Regulation provides that:

   'The Commission shall, after obtaining technical advice from ESMA, review the situation in the credit rating market. Following that review, the Commission shall, by 1 January 2016, submit a report to the European Parliament and to the Council, accompanied by a legislative proposal if appropriate, assessing, in particular:

   (a) Whether there is an need to extend the scope of the obligations referred to in Article 8b to include any other financial credit products;
   (b) Whether the requirements referred to in Articles 6, 6a and 7 have sufficiently mitigated conflicts of interest;
   (c) Whether the scope of the rotation mechanism referred to in Article 6b should be extended to other asset classes and whether it is appropriate to use differentiated lengths of periods across asset classes;
   (d) The appropriateness of existing and alternative remuneration models;
   (e) Whether there is a need to implement other measures to foster competition in the credit rating market;
   (f) The appropriateness of additional initiatives to promote competition in the credit rating market against the background of the evolution of the structure of the sector;
   (g) Whether there is a need to propose measures to reduce overreliance on ratings.[366]
   (h) Market concentration levels, the risks arising from high concentration and the impact on the overall stability of the financial sector.'

2. Article 39(4) of the CRA Regulation states that:

   'The Commission shall, after obtaining technical advice from ESMA, review the situation in the credit rating market for structured finance instruments, in particular the credit rating market for re-securitisations. Following that review, the Commission shall, by 1 July 2016 submit a report to the European Parliament and to the Council, accompanied by a legislative proposal if appropriate, assessing in particular :

   (a) The availability of sufficient choice to comply with the requirements set out in Articles 6b and 8c;

   (b) Whether it is appropriate to shorten or extend the maximum duration of the contractual relationship referred to in Article 6b(1) and the minimum period before the credit rating agency may re-enter into a contract with an issuer or a related third party for the issuing of credit ratings on re-securitisations referred to in Article 6b(3);

   (c) Whether it is appropriate to amend the exemption referred to in the second sub paragraph of Article 6b(2).'

[366] Input for this section of the report will be provided through the Technical Advice regarding reducing reliance on credit ratings To be provided in accordance with Article 39 (b) 1 of the CRA Regulation

8.2 Annex II: List of contributors to the Call for Evidence on Competition, Choice and Conflicts of interest in the CRA Industry[367]

1. Agence France Locale
2. L'Air Liquide
3. A.M. Best Europe - Rating Services Limited
4. Amundi Asset Management
5. Arbeitsgemeinschaft für betriebliche Altersversorgung e.V. (ABA)
6. ARC Ratings S.A.
7. Assekurata Assekuranz Rating-Agentur GmbH
8. Association for Financial Markets in Europe
9. The Association Française de la Gestion Financière (AFG)
10. Association Française des Investisseurs Institutionnels (Af2i)
11. Association Française des Trésoriers d'Entreprise (AFTE)
12. The Association of Corporate Treasurers
13. Barclays PLC
14. Bundesverband investment und asset management e.v. (bvi)
15. La Caisse Centrale du Crédit Immobilier de France (3CIF)
16. Cerved Rating Agency S.p.A
17. The CFA Institute
18. Commerzbank AG
19. Compagnie Financière du Groupe Michelin, « Senard et Cie »
20. CRIF S.p.A.
21. Czech Capital Market Association
22. Dagong Europe Credit Rating

[367] This list includes the vast majority of those who provided written responses as well as informal feedback on some or all of the questions asked in the Call for Evidence. However, a small number of respondents asked to remain anonymous.

23. DBRS Ratings Limited

24. Deutsches Aktieninstitut

25. Die Deutsche Kreditwirtshaft (German Banking Industry Committee)

26. Dutch State Treasury Agency

27. Egan Jones Ratings Co

28. ENI S.p.A.

29. The European Association of Corporate Treasurers

30. The European Association of Credit Rating Agencies

31. The European Covered Bond Council

32. European Fund and Asset Managers Association

33. The European Investment Bank

34. European Stability Mechanism (ESM) and European Financial Stability Facility (EFSF)

35. FCE Bank plc

36. FERI EuroRating Services AG

37. Fitch Ratings

38. GDF-Suez

39. Global Warning SAS

40. Groupe Auchan

41. HR Ratings de México, S.A. de C.V.

42. HSBC Holdings PLC

43. ICAP Group

44. Italian Dipartimento del Tesoro

45. International Capital Markets Association

46. INVERCO (Spanish Association of Collective Investment Institutions and Pension Funds)

47. The Investment Association

48. Ministry of Finance Republic of Lithuania
49. Ministry of Finance Republic of Slovenia
50. Moody's Investors Service Limited
51. National Treasury Management Agency, Ireland
52. Nationwide Building Society
53. Norges Bank Investment Management (NBIM)
54. Pernod Ricard
55. Phoenix Group
56. The Royal Bank of Scotland plc
57. RTL Group s.a.
58. Sanofi-aventis Groupe
59. Scope Ratings A.G
60. Société Générale Corporate and Investment Banking
61. Standard & Poor’s Ratings Services
62. University of the West of Scotland, Professor Angus Duff

8.3 Annex III: Opinion of the Securities and Markets Stakeholder Group

http://www.esma.europa.eu/system/files/2015-smsg-018_cra_competition_choice_and_conflicts_of_interest.pdf

8.4 Annex IV: Tables

Table 1: List of Registered and Certified CRAs

Name of CRA	Country	Status	Date	Registered
Euler Hermes Rating GmbH	Germany	Registered	16.11.2010	NCA
Japan Credit Rating Agency Ltd	Japan	Certified	06.01.2011	NCA
BCRA-Credit Rating Agency AD	Bulgaria	Registered	06.04.2011	NCA
Feri EuroRating Services AG	Germany	Registered	14.04.2011	NCA
Creditreform Rating AG	Germany	Registered	18.05.2011	NCA
Scope Ratings GmbH	Germany	Registered	24.05.2011	NCA
ICAP Group SA	Greece	Registered	07.07.2011	NCA
GBB-Rating Gesellschaft für Bonitätsbeurteilung mbH	Germany	Registered	28.07.2011	NCA
Assekurata Assekuranz Rating-Agentur GmbH	Germany	Registered	18.08.2011	NCA
ARC Ratings, S.A. (previously Companhia Portuguesa de Rating, S.A)	Portugal	Registered	26.08.2011	NCA
AM Best Europe-Rating Services Ltd.	UK	Registered	08.09.2011	NCA
DBRS Ratings Limited	UK	Registered	31.10.2011	NCA
Fitch Ratings*	France, Germany, Italy, Poland, Spain, UK (2 entities)	Registered	31.10.2011	NCA
Moody's*	Cyprus, France, Germany, Italy, Spain, UK** (2 entities)	Registered	31.10.2011	NCA
Standard & Poor's*	France, Italy, UK	Registered	31.10.2011	NCA
CRIF S.p.A.	Italy	Registered	22.12.2011	NCA
Capital Intelligence (Cyprus) Ltd	Cyprus	Registered	08.05.2012	NCA
European Rating Agency, a.s.	Slovakia	Registered	30.07.2012	NCA
Axesor SA	Spain	Registered	01.10.2012	ESMA
CERVED Group S.p.A.	Italy	Registered	20.12.2012	NCA
Kroll Bond Rating Agency	USA	Certified	20.03.2013	ESMA
The Economist Intelligence Unit Ltd	UK	Registered	03.06.2013	ESMA
Dagong Europe Credit Rating Srl (Dagong Europe)	Italy	Registered	13.06.2013	ESMA
Spread Research SAS	France	Registered	01.07.2013	ESMA
EuroRating Sp. z o.o.	Poland	Registered	07.05.2014	ESMA
HR Ratings de México, S.A. de C.V. (HR Ratings)	Mexico	Certified	07.11.2014	ESMA
Egan-Jones Ratings Co. (EJR)	USA	Certified	12.12.2014	ESMA
modeFinance S.r.l.	Italy	Registered	10.07.2015	ESMA

*Note: Group of CRAs:
Fitch: Fitch Deutschland GmbH (Germany), Fitch France S.A.S. (France), Fitch Italia S.p.A. (Italy), Fitch Polska S.A. (Poland), Fitch Ratings CIS Limited (UK), Fitch Ratings España S.A.U. (Spain), Fitch Ratings Limited (UK);
Moody's: Moody's Deutschland GmbH (Germany), Moody's France S.A.S. (France), Moody's Investors Service Cyprus Ltd (Cyprus), Moody's Investors Service España S.A. (Spain), Moody's Investors Service Ltd (UK), Moody's Italia S.r.l. (Italy), Moody's Investors Service EMEA Ltd (UK);
Standard & Poor's: Standard & Poor's Credit Market Services Europe Limited (UK), Standard & Poor's Credit Market Services France S.A.S. (France), Standard & Poor's Credit Market Services Italy S.r.l. (Italy).
** Note: Moody's Investors Service EMEA Ltd (UK) was registered on 24.11. 2014.

Source: ESMA

Table 2: CRAs' business models as at 30 September 2015

CRA short name	Business models used	
	Issuer-pays	Investor/Subscriber-pays
AM Best	X	
ARC	X	
ASSEKURATA	X	
Axesor	X	X
BCRA	X	
Capital Intelligence	X	X
CERVED	X	X
Creditreform	X	
CRIF	X	X
Dagong	X	
DBRS	X	
EIU		X
Euler Hermes	X	X
European Rating Agency	X	
EuroRating	X	X
Feri	X	X
Fitch	X	X
GBB	X	
ICAP	X	X
Moody's	X	
S&P	X	X
Scope	X	X
Spread Research	X	X

Source: ESMA

Table 3: Categories of asset class rated by each CRA 2009-2014

CRA	2009 FI	2009 IN	2009 CO	2009 SV	2009 SS	2009 PE	2009 SN	2009 SF	2009 CB
AM Best		IN	CO						
ARC			CO						
ASSEKURATA		IN							
Axesor									
BCRA	FI	IN			SS				
Capital Intelligence	FI		CO	SV					
CERVED			CO						
Creditreform			CO						
CRIF									
Dagong									
DBRS	FI	IN	CO	SV	SS	PE		SF	CB
EIU									
Euler Hermes	FI		CO						
European Rating Agency			CO		SS				
EuroRating									
Feri				SV					
Fitch	FI	IN	CO	SV	SS		SN	SF	CB
GBB	FI								
ICAP			CO						
Moody's	FI	IN	CO	SV	SS	PE	SN	SF	CB
S&P	FI	IN	CO	SV	SS	PE	SN	SF	CB
Scope			CO						
Spread Research									

CRA	2010 FI	2010 IN	2010 CO	2010 SV	2010 SS	2010 PE	2010 SN	2010 SF	2010 CB
AM Best		IN	CO						
ARC			CO						
ASSEKURATA		IN							
Axesor									
BCRA	FI	IN			SS				
Capital Intelligence	FI		CO	SV					
CERVED			CO						
Creditreform			CO					**SF**	
CRIF			CO						
Dagong									
DBRS	FI	IN	CO	SV	SS	PE		SF	CB
EIU									
Euler Hermes	FI		CO						
European Rating Agency			CO		SS				
EuroRating									
Feri				SV					
Fitch	FI	IN	CO	SV	SS		SN	SF	CB
GBB	FI								
ICAP			CO						
Moody's	FI	IN	CO	SV	SS	PE	SN	SF	CB
S&P	FI	IN	CO	SV	SS	PE	SN	SF	CB
Scope			CO						
Spread Research									

CRA	2011 FI	2011 IN	2011 CO	2011 SV	2011 SS	2011 PE	2011 SN	2011 SF	2011 CB
AM Best		IN	CO						
ARC			CO						
ASSEKURATA		IN							
Axesor									
BCRA	FI	IN			SS				
Capital Intelligence	FI		CO	SV					
CERVED			CO						
Creditreform			CO						**CB**
CRIF			CO						
Dagong									
DBRS	FI	IN	CO	SV	SS	PE		SF	CB
EIU									
Euler Hermes	FI		CO						
European Rating Agency					SS				
EuroRating									
Feri				SV					
Fitch	FI	IN	CO	SV	SS		SN	SF	CB
GBB	FI								
ICAP			CO						
Moody's	FI	IN	CO	SV	SS	PE	SN	SF	CB
S&P	FI	IN	CO	SV	SS	PE	SN	SF	CB
Scope			CO						
Spread Research									

CRA	2012 FI	2012 IN	2012 CO	2012 SV	2012 SS	2012 PE	2012 SN	2012 SF	2012 CB
AM Best		IN	CO						
ARC	**FI**		CO						
ASSEKURATA		IN							
Axesor			CO						
BCRA	FI	IN			SS				
Capital Intelligence	FI		CO	SV					
CERVED			CO						
Creditreform			CO					SF	CB
CRIF			CO						
Dagong									
DBRS	FI	IN	CO	SV	SS	PE	**SN**	SF	CB
EIU									
Euler Hermes	FI		CO						
European Rating Agency					SS				
EuroRating									
Feri				SV					
Fitch	FI	IN	CO	SV	SS		SN	SF	CB
GBB	FI								
ICAP			CO						
Moody's	FI	IN	CO	SV	SS	PE	SN	SF	CB
S&P	FI	IN	CO	SV	SS	PE	SN	SF	CB
Scope			CO						
Spread Research									

CRA	2013 FI	2013 IN	2013 CO	2013 SV	2013 SS	2013 PE	2013 SN	2013 SF	2013 CB
AM Best		IN	CO						
ARC			CO						
ASSEKURATA		IN							
Axesor			CO						
BCRA	FI	IN			SS				
Capital Intelligence	FI		CO	SV					
CERVED			CO						
Creditreform			CO					SF	CB
CRIF			CO						
Dagong	FI								
DBRS	FI	IN	CO	SV	SS	PE	SN	SF	CB
EIU				SV					
Euler Hermes	FI		CO						
European Rating Agency					SS				
EuroRating									
Feri	**FI**		**CO**	SV					
Fitch	FI	IN	CO	SV	SS		SN	SF	CB
GBB	FI								
ICAP			CO						
Moody's	FI	IN	CO	SV	SS	PE	SN	SF	CB
S&P	FI	IN	CO	SV	SS	PE	SN	SF	CB
Scope			CO					**SF**	
Spread Research			CO						

CRA	2014 FI	2014 IN	2014 CO	2014 SV	2014 SS	2014 PE	2014 SN	2014 SF	2014 CB
AM Best		IN	CO						
ARC			CO	**SV**					
ASSEKURATA		IN							
Axesor			CO						
BCRA	FI	IN		**SV**	SS				
Capital Intelligence	FI		CO	SV					
CERVED			CO						
Creditreform			CO					SF	CB
CRIF			CO						
Dagong	FI	**IN**							
DBRS	FI	IN	CO	SV	SS	PE	SN	SF	CB
EIU				SV					
Euler Hermes	FI		CO						
European Rating Agency					SS				
EuroRating	FI		CO						
Feri	FI		CO	SV					
Fitch	FI	IN	CO	SV	SS		SN	SF	CB
GBB	FI								
ICAP			CO						
Moody's	FI	IN	CO	SV	SS	PE	SN	SF	CB
S&P	FI	IN	CO	SV	SS	PE	SN	SF	CB
Scope	**FI**		CO					SF	
Spread Research			CO						

Legend:

FI	Corporate - Financial
IN	Corporate - Insurance
CO	Corporate - Non Financial
SV	Sovereign
SS	Sub-sovereign
PE	Public entities
SN	Supranational
SF	Structured Finance
CB	Covered Bonds
	Non registered
XX	Dark blue: first occurance

Source: ESMA, CEREP

Table 4: Total ratings outstanding by category of asset class (EU entities/instruments)

	Corporate Financial			Corporate Insurance			Corporate non financial			Sovereign & Sub-sovereign			Structured Finance			Covered Bonds			Total		
CRAShortName	2009	2014	Variation	2009	2014	Variation	2009	2014	Variation	2009	2014	Variation	2009	2014	Variation	2009	2014	Variation	2009	2014	Variation
AM Best				166	146	-12%	23	9	-61%										189	155	-18%
ARC							7	5	-29%										7	5	-29%
ASSEKURATA					7														0	7	
Axesor								61											0	61	
BCRA	5	11	120%	6	8	33%				13	3	-77%							24	22	-8%
Capital Intelligence	33	28	-15%							14	3	-79%							47	31	-34%
CERVED							98735	28903	-71%										98735	28903	-71%
Creditreform							10	66	560%					6			27		10	99	890%
CRIF								48											0	48	
Dagong		6			1														0	7	
DBRS	33	46	39%				8	11	38%		35		61	662	985%		187		102	941	823%
EIU											26								0	26	
Euler Hermes	1	3	200%				15	29	93%										16	32	100%
European Rating Agency	0						1		-100%	9	4	-56%							10	4	-60%
EuroRating		32						13											0	45	
Feri		4						4		25	25	0%							25	33	32%
Fitch	356	280	-21%	48	43	-10%	398	526	32%	225	205	-9%	5738	4205	-27%	3640	2497	-31%	10405	7756	-25%
GBB	185	192	4%																185	192	4%
ICAP							4401	1619	-63%										4401	1619	-63%
Moody's	521	303	-42%	30	24	-20%	539	586	9%	393	427	9%	5386	3713	-31%	6821	6057	-11%	13690	11110	-19%
S&P	370	346	-6%	383	285	-26%	505	831	65%	161	168	4%	5839	4064	-30%	4927	4966	1%	12185	10660	-13%
Scope		21						102						7					0	130	
Spread Research								42											0	42	
Total	**1504**	**1272**	**-15%**	**633**	**514**	**-19%**	**104642**	**32855**	**-69%**	**840**	**896**	**7%**	**17024**	**12657**	**-26%**	**15388**	**13734**	**-11%**	**140031**	**61928**	**-56%**

Source: ESMA, CEREP

Table 5: Total ratings outstanding by EU Member State and by asset class

	Corporate Financial			Corporate Insurance			Corporate non financial			Sovereign & Sub-sovereign			Structured Finance			Covered Bonds			Total		
Country	2009	2014	Variation	2009	2014	Variation	2009	2014	Variation	2009	2014	Variation	2009	2014	Variation	2009	2014	Variation	2009	2014	Variation
AT	31	32	3%	11	11	0%	19	30	58%	22	28	27%	39	14	-64%	202	429	112%	324	544	68%
BE	22	21	-5%	13	13	0%	26	43	65%	23	26	13%	116	72	-38%	2	80	3900%	202	255	26%
BG	11	18	64%	7	8	14%	3	4	33%	26	15	-42%	6		-100%				53	45	-15%
CY	17	10	-41%	1	1	0%	3	10	233%	8	10	25%				1	2	100%	30	33	10%
CZ	8	9	13%	3	3	0%	6	17	183%	26	23	-12%					12		43	64	49%
DE	364	355	-2%	125	108	-14%	164	299	82%	53	41	-23%	1680	961	-43%	8609	4548	-47%	10995	6312	-43%
DK	18	22	22%	13	3	-77%	17	22	29%	16	19	19%	62	2	-97%	1531	1794	17%	1657	1862	12%
EE	1		-100%				2	3	50%	10	11	10%							13	14	8%
ES	115	71	-38%	18	14	-22%	41	150	266%	84	81	-4%	2973	2363	-21%	572	1134	98%	3803	3813	0%
FI	9	13	44%	12	7	-42%	24	28	17%	14	20	43%	21	24	14%	18	73	306%	98	165	68%
FR	179	123	-31%	67	51	-24%	142	222	56%	84	97	15%	527	445	-16%	2215	2683	21%	3214	3621	13%
GB	224	201	-10%	186	152	-18%	584	711	22%	54	142	163%	8004	5556	-31%	274	362	32%	9326	7124	-24%
GR	22	13	-41%				4417	1627	-63%	13	13	0%	125	65	-48%	11	32	191%	4588	1750	-62%
HR	3	3	0%				2	4	100%	13	14	8%							18	21	17%
HU	12	8	-33%				5	7	40%	16	14	-13%				84	10	-88%	117	39	-67%
IE	85	42	-51%	65	51	-22%	36	74	106%	8	13	63%	236	206	-13%	784	566	-28%	1214	952	-22%
IT	119	87	-27%	17	13	-24%	98793	29063	-71%	178	118	-34%	1231	1086	-12%	34	222	553%	100372	30589	-70%
LT	3		-100%				3	3	0%	8	9	13%							14	12	-14%
LU	57	51	-11%	19	17	-11%	82	187	128%	10	18	80%	23	49	113%	320	280	-13%	511	602	18%
LV	3	1	-67%				1	1	0%	11	13	18%	2		-100%	8		-100%	25	15	-40%
MT	3	3	0%	2	4	100%	2	1	-50%	9	9	0%							16	17	6%
NL	91	67	-26%	45	33	-27%	175	205	17%	13	25	92%	1542	1446	-6%	191	689	261%	2057	2465	20%
PL	18	47	161%	6	4	-33%	12	37	208%	40	39	-3%	1	6	500%	12	34	183%	89	167	88%
PT	33	22	-33%	4	3	-25%	25	27	8%	28	22	-21%	422	342	-19%	54	133	146%	566	549	-3%
RO	6	8	33%				2	3	50%	15	14	-7%							23	25	9%
SE	31	32	3%	16	11	-31%	51	68	33%	28	37	32%	14	20	43%	466	613	32%	606	781	29%
SI	14	10	-29%	3	7	133%	1	7	600%	9	11	22%							27	35	30%
SK	5	3	-40%				4	2	-50%	21	14	-33%					38		30	57	90%
Total	**1504**	**1272**	**-15%**	**633**	**514**	**-19%**	**104642**	**32855**	**-69%**	**840**	**896**	**7%**	**17024**	**12657**	**-26%**	**15388**	**13734**	**-11%**	**140031**	**61928**	**-56%**

Source: ESMA, CEREP