



European Securities and
Markets Authority

Consultation Paper

**Update of the guidelines on the application of the endorsement regime
under Article 4(3) of the Credit Rating Agencies Regulation**



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1 Responding to this paper

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

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by 3 July 2017.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

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

The collection of confidential responses is without prejudice to the scope of Regulation (EC) No 1049/2001. Possible requests for access to documents will be dealt in compliance with the requirements and obligations laid down in Regulation (EC) No 1049/2001.

Data protection

Information on data protection can be found at <https://www.esma.europa.eu/data-protection> under the heading Data Protection.

Who should read this paper

This paper may be of interest to users of credit ratings, credit rating agencies and entities interested in applying to be a registered CRA.

2 Definitions, legislative references and acronyms

CESR	Committee of European Securities Regulators
ESMA	European Securities and Markets Authority
The Commission	The European Commission
Consultation Paper	Consultation paper: Update of the guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation
CRA Regulation	Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit ratings agencies as amended by Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011, Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011, Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013, and Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014
CRA 1	Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit ratings agencies
CRA 2	Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011
CRA 3	Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013
ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC
RTS on Registration	Commission delegated regulation (EU) No 449/2012 of 21 March 2012 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards on information for registration and certification of credit rating agencies
The 2010 technical advice	Technical Advice to the European Commission on the Equivalence between the Japanese Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies” (CESR/10-33) adopted in June 2010
The 2011 Guidelines on Endorsement	Guidelines on the application of the endorsement regime under Article 4(3) of the CRA Regulation (ESMA/2011/139) adopted in May 2011
The Methodological Framework	The Methodological Framework for assessing a third-country legal and supervisory framework for the purposes of endorsement and equivalence as provided in Annex II to the final report of the 2011

	Guidelines on Endorsement and updated in Annex III to this Consultation Paper
The Guidelines on Periodic Information	Guidelines on periodic information to be submitted to ESMA by Credit Rating Agencies (ESMA/2015/609) adopted in June 2015
EU CRA	A credit rating agency registered with ESMA
Endorsing CRA	An EU CRA which endorses or has endorsed one or more credit ratings in accordance with Article 4(3) of the CRA Regulation
Third-country CRA	A CRA which is registered and subject to supervision in a non-EU country or jurisdiction
Group of CRAs	As per Article 3(1)(m) of the CRA Regulation 'group of CRAs' means a group of undertakings established in the Union consisting of a parent undertaking and its subsidiaries within the meaning of Articles 1 and 2 of Directive 83/349/EEC as well as undertakings linked to each other by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC and whose occupation includes the issuing of credit ratings. For the purposes of Article 4(3)(a), a group of credit rating agencies shall also include credit rating agencies established in third countries

3 Executive Summary

Reasons for publication

Endorsement is one of two regimes provided in the CRA Regulation that allow credit ratings issued in a third country to be used for regulatory purposes in the EU – the other being equivalence/certification. Article 21(3) of the CRA Regulation requires ESMA to issue and update guidelines on the application of the endorsement regime specified under Article 4(3) of the same Regulation. This Consultation Paper proposes to update the previously issued 2011 Guidelines on Endorsement.

The proposed update of the 2011 Guidelines on Endorsement is mainly driven by the need to reflect the changes to Articles 6-12 and Annex I introduced by CRA 3, which will enter into force for the purposes of equivalence and endorsement on 1 June 2018. On that basis, ESMA has to update the Methodological Framework on which ESMA relies for assessing a third-country legal and supervisory framework for the purposes of endorsement and equivalence. This Methodological Framework is provided in Annex II of the 2011 Guidelines on Endorsement. By 1 June 2018, ESMA should also have completed a reassessment of all the previously assessed third-country legal and regulatory frameworks against the new requirements based on the updated Methodological Framework (provided in Annex III).

ESMA has taken this opportunity to reassess its approach to endorsement more broadly, based on the supervisory experience acquired since the adoption of the 2011 Guidelines on Endorsement. The proposed changes and clarification of the 2011 Guidelines on Endorsement focus in particular on ESMA's understanding of points (b), (c), (d), and (e) of Article 4(3) of the CRA Regulation.

Furthermore, some parts of the 2011 Guidelines on Endorsement relate to the establishment of ESMA, the initial registration of CRAs and various transitional arrangements. The proposed updated Guidelines on Endorsement do not include these parts, as they are no longer relevant. Finally, some information in the 2011 Guidelines on Endorsement was not addressed to market participants but referred to ESMA's internal processes. This information has also been excluded from the proposed updated guidelines on Endorsement, but is, for context, summarised in Section 4 of this Consultation Paper.

Contents

Section 4 provides an overview of the phases of the endorsement process and provides the relevant background to the proposed updated Guidelines on Endorsement.

Section 5 describes ESMA's approach to assessing a third-country legal and supervisory framework for the purposes of endorsement and equivalence and the key changes made to the Methodological Framework.

Section 6 provides an overview of the proposed changes to the 2011 Guidelines on Endorsement.

Annex I summarises the questions listed in the Consultation paper.

Annex II contains the proposed updated Guidelines on Endorsement.

Annex III contains the updated Methodological Framework for assessing third-country legal and supervisory frameworks taking into account the new CRA 3 requirements. This Annex is made up of three parts:

- a background section;
- a table summarising the material changes introduced to the Methodological Framework; and
- the consolidated Methodological Framework incorporating the new CRA 3 requirements.

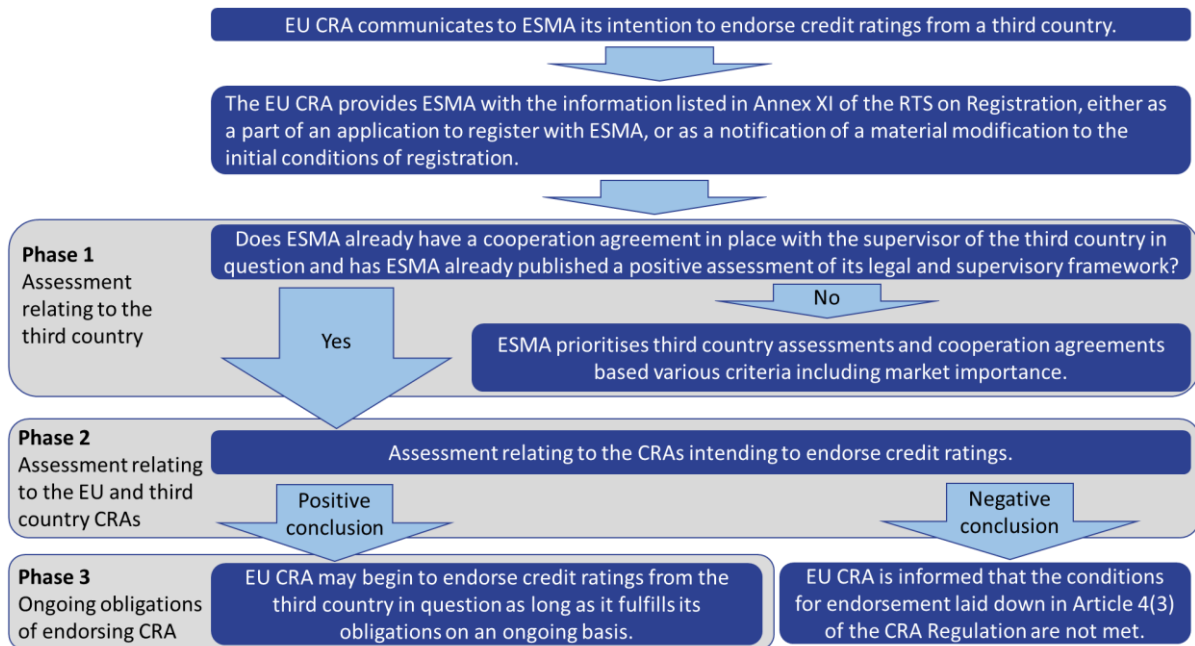
Next steps

The consultation will be open for three months. ESMA will consider the feedback it receives to the consultation with a view to finalising the updated Guidelines on Endorsement and publishing a final report in Q4 2017.

4 Overview of the phases of the endorsement process

1. The aim of this Section is to outline the different steps in ESMA's assessment of the fulfilment of the conditions laid down in Article 4(3) of the CRA Regulation in order for an EU CRA to endorse credit ratings.
2. When registering with ESMA, where an EU CRA intends to endorse credit ratings issued in third countries, it must communicate to ESMA its intention to do so pursuant to Article 24 of the RTS on Registration and submit the information referred to in Annex XI of the same RTS. As per Section VI of the Guidelines on Periodic Information, ESMA considers the use of endorsement to be an example of a material change to the initial conditions of registration within the meaning of Article 14(3) of the CRA Regulation. Consequently, an EU CRA, which decides to endorse credit ratings issued in third countries subsequent to its registration with ESMA, should notify ESMA of its intention to do so without undue delay and provide the information listed in Annex XI of the RTS on Registration.
3. An EU CRA may endorse credit ratings in accordance with Article 4(3) of the CRA Regulation, when ESMA has completed two separate assessments concluding that the conditions laid down in Article 4(3) are fulfilled: (1) assessment of the conditions relating to the legal and supervisory framework of the third country and (2) assessment of the conditions relating to the CRAs intending to endorse credit ratings. The assessments are carried out by ESMA based on information provided by the EU CRA intending to endorse credit ratings issued in a third country as well as information obtained from the third-country supervisor.
4. Subsequent to the assessments, an EU CRA which endorses credit ratings issued in a third country should ensure continued compliance with all the conditions set out in article 4(3) of the CRA Regulation.
5. The below figure summarises the steps in the process leading to endorsement of a credit rating issued in a third country.

FIGURE 1. PHASES IN THE APPLICATION OF THE ENDORSEMENT REGIME



6. The following sections clarify which of the conditions laid down in Article 4(3) of the CRA Regulation ESMA assesses when an EU CRA communicates its intention to endorse credit ratings from a particular third country.

4.1 Phase 1: Assessment relating to the third country

7. As part of ESMA’s assessment of the conditions in Article 4(3) relating to the supervisory and legal framework of the third country from which endorsement is intended (hereinafter “the third-country assessment”), ESMA checks the following:

- that the local legal and regulatory system imposes requirements which meet a minimum standard (see Methodological Framework in Annex III and Article 4(3)(b) of the CRA Regulation);
- that there is a supervisor in the third country which authorises or registers third-country CRAs and subjects them to supervision (Article 4(3)(f) of the CRA Regulation);
- that the regulatory regime in that third country prevents interference by the competent authorities and other public authorities of that third country with the content of credit ratings and methodologies (Article 4(3)(g) of the CRA Regulation); and
- that ESMA has established a cooperation agreement with the supervisor of the third country (Article 4(3)(h) of the CRA Regulation).

8. This assessment is carried out by ESMA using the Methodological Framework provided in Annex III to this document and on the basis of information obtained from the third-country supervisor and, where relevant, the information provided by the EU CRA under paragraphs 1(e), 3 and 6 of Annex XI of the RTS on Registration.
9. The result of the third-country assessment is made public by ESMA. Once published, the third-country assessment can be relied upon by all EU CRAs intending to endorse credit ratings from that third country. A positive third-country assessment by ESMA is a minimum requirement and does not relieve the endorsing CRA from fulfilling its ongoing obligations as described in the proposed updated guidelines on Endorsement.

4.2 Phase 2: Assessment relating to the CRAs intending to endorse credit ratings

10. As part of ESMA's assessment of the conditions in Article 4(3) relating to the CRAs intending to endorse credit ratings, ESMA checks the following:
 - that the credit rating activities resulting in the issuing of the credit ratings to be endorsed will be undertaken in whole or in part by the EU CRA or a CRA belonging to the same group of CRAs (article 4(3)(a) of the CRA Regulation);
 - that the EU CRA has put in place measures to monitor that the conduct of the credit rating activities by the third-country CRA is fulfilling requirements which are as stringent as the EU Regulation (Article 4(3)(b) of the CRA Regulation as explained further in paragraph 13 of the proposed updated Guidelines on Endorsement);
 - that the EU CRA has provided an indication of the objective reasons for credit ratings to be elaborated in a third country (Article 4(3)(e) of the CRA Regulation as explained further in paragraphs 19-20 in the proposed updated Guidelines on Endorsement); and
 - that the third-country CRA is authorised or registered, and is subject to supervision in the third country where it is established (Article 4(3)(f) of the CRA Regulation).
11. ESMA carries out this assessment on the basis of information provided by the EU CRA in accordance with paragraphs 1, 2, 4 and 5 of Annex XI of the RTS on Registration and, where relevant, information obtained from the third-country supervisor.

4.3 Phase 3: Ongoing obligations of the endorsing CRA

12. Subsequent to the above assessments, an EU CRA which endorses credit ratings issued in a third country should ensure continued compliance with the conditions set out in article 4(3) of the CRA Regulation including the ongoing obligations, which are further described in the proposed updated Guidelines on Endorsement (See Section 6 and Annex II). Endorsing a credit rating without complying with the conditions set out in Article 4(3) of the CRA Regulation constitutes an infringement of the CRA Regulation.

Point 1 of Section I of Annex III of the CRA Regulation

The credit rating agency infringes Article 4(3) by endorsing a credit rating issued in a third country without complying with the conditions set out in that paragraph, unless the reason for that infringement is outside the credit rating agency's knowledge or control.

4.4 Summary of the conditions and the phases of endorsement

13. The below table provides a summary of the conditions laid down in Article 4(3) which should be fulfilled for the endorsement regime to be operational. The table indicates which of the conditions are assessed by ESMA before an EU CRA begins endorsing credit ratings.
14. The symbol “✓” indicates the phase in which a requirement is assessed. The exclamation mark “!” indicates an obligation on the CRA to notify ESMA without undue delay of any material changes to the conditions under which the assessments (phases 1 and 2) were carried out.

FIGURE 1: CONDITIONS AND PHASES OF ENDORSEMENT

Relevant Level 1 provision	Conditions laid down in Article 4(3)	Assessment and approval relating to...		Ongoing obligations of endorsing CRA Phase 3
		...the third country Phase 1	...the endorsing and/or third-country CRA Phase 2	
4(3)(a)	The relationship between the endorsing CRA and the third-country CRA corresponds to the requirement in point (a). <i>(points 1-2 of Annex XI of the RTS on Registration)</i>		✓	!
4(3)(b)	The legal and supervisory framework of third country meets a minimum standard. <i>(point 3 of Annex XI of the RTS on Registration)</i>	✓		!
4(3)(b)	There are adequate measures put in place by the endorsing CRA to verify that the third-country CRA is fulfilling requirements which are at least as stringent as the relevant EU requirements. <i>(point 4 of Annex XI of the RTS on Registration)</i>		✓	!
4(3)(b)	The endorsing CRA is able to demonstrate on an ongoing basis that the third-country CRA is fulfilling requirements which are at least as stringent as the relevant EU requirements.			✓
4(3)(c)	The endorsing CRA ensures on an ongoing basis that the ability of ESMA to assess and monitor the compliance of the third-country CRA with the requirements referred to in point (b) is not limited;			✓
4(3)(d)	The endorsing CRA makes available on request to ESMA all the information necessary to enable ESMA to supervise on an ongoing basis the compliance with the requirements of this Regulation.			✓
4(3)(e)	There is a satisfactory indication of objective reasons for credit ratings to be issued in a third country.		✓	!

	<i>(point 5 of Annex XI of the RTS on Registration)</i>			
4(3)(e)	The endorsing CRA has documented an objective reason for elaborating every single endorsed rating in a third country.			✓
4(3)(f)	There is a supervisor in the third country which authorises or registers third-country CRAs and subjects them to supervision.	✓		!
4(3)(f)	The third-country CRA is authorised or registered, and is subject to supervision, in the third country where it is established. <i>(point 2(e) of Annex XI of the RTS on Registration)</i>		✓	!
4(3)(g)	The regulatory regime in the third country prevents interference by the competent authorities and other public authorities of that third country with the content of credit ratings and methodologies <i>(point 6 of Annex XI of the RTS on Registration)</i>	✓		!
4(3)(h)	An appropriate cooperation arrangement has been established between ESMA and the relevant supervisory authority of the CRA established in a third country.	✓		

5 Updated Methodological Framework

15. The updated Methodological Framework for assessing a third-country legal and supervisory framework for the purposes of endorsement and equivalence is provided in Annex III. ESMA is taking this opportunity to remove obsolete paragraphs including references to ESMA's legal predecessor, CESR. No changes have been introduced to the approach to assessing third countries against requirements predating CRA 3. This means that third countries whose legal and supervisory framework has already been assessed by ESMA will only be checked in relation to the CRA 3 requirements.
16. The updated Methodological Framework reflects the changes to Articles 6-12 and Annex I introduced by the CRA 3. However, the following new provisions introduced by CRA 3 were explicitly excluded from the scope of Article 4(3)(b): 6a, 6b, 8a, 8b, 8c and 11a, point (ba) of point 3 and points 3a and 3b of Section B of Annex I. The rationale for excluding these provisions from the endorsement assessment is provided in Recital 48 of CRA 3: *"Some of the provisions introduced by this regulation should not apply to the equivalence and endorsement assessments. This is the case for those provisions that only establish obligations on issuers but not on credit rating agencies. In addition, provisions that relate to the structure of the credit rating market within the Union rather than establishing rules of conduct for credit rating agencies should not be considered in this context."*
17. ESMA relies on the updated Methodological Framework when assessing a third-country legal and supervisory framework for the purposes of endorsement as described above in section 4.1. However, ESMA does not rely on the Methodological Framework when assessing that the *conduct* of a third-country CRA is as stringent as the EU requirements as described in section 6.1.

18. The updated Methodological Framework also contains paragraphs of section III “*Relationship between equivalence and endorsement*” of the 2011 Guidelines on Endorsement which have not been included in the proposed updated Guidelines on Endorsement. By simplifying the language in these paragraphs ESMA aims to provide a clearer picture of the relationship between third-country assessments which ESMA carries out for the purposes of endorsement, and equivalence.
19. In a letter to ESMA’s predecessor, CESR, the Commission committed to a procedure, whereby ESMA provides its third-country equivalence assessment in a technical advice before the Commission takes a decision on equivalence¹. However, whereas ESMA has the power to issue and update guidelines on the application of the endorsement regime, the power to specify further or amend the criteria for assessing equivalence lies, in accordance with Article 5(6) third subparagraph of the CRA Regulation, with the Commission². At the date of adoption of this consultation paper, the Commission had not exercised this power. Without prejudice to any future delegated act on equivalence adopted by the Commission, it is clarified that ESMA carries out assessments of third-country legal and supervisory frameworks for the purposes of endorsement and equivalence based on the same Methodological Framework³. Unless otherwise stated, a positive assessment of a third-country legal and supervisory framework by ESMA, therefore, also implies a positive advice to the Commission on equivalence.
20. If the legal and supervisory framework of a particular third country ceases to meet the conditions set out in Article 4(3)(b), (f), and (g) of the CRA Regulation, credit ratings issued in that third country will no longer be eligible for endorsement. Should ESMA, on this basis, suspend the use of certain credit ratings for regulatory purposes in the EU, Article 24(4) of the CRA Regulation provides for a transitional period, during which market participants can continue to rely on credit ratings that have already been endorsed from such a country. This transitional period is 10 days for ratings relating to entities and instruments that are rated by another EU CRA and 3-6 months for ratings relating to entities and instruments that are not rated by another registered CRA.

¹ Brussels, 12 June 2009 | MARKT/G3/MTF/mg Ares (2009). Letter addressed to Mr Eddy Wymeersch Chairman Committee of European Securities Regulators (CESR). Subject: Request for CESR technical advice on the equivalence between certain third country legal and supervisory frameworks and the EU Regulatory Regime for credit rating agencies. See section 1.2 of the attached mandate “*Mechanism for assessing the equivalence*”. The relevant section of the letter can be found on page 228 of CESR’s “*Technical Advice to the Commission on the Equivalence between the Japanese Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies*” Date: 9th June 2010, Ref.: CESR/10- 333 available at https://www.esma.europa.eu/sites/default/files/library/2015/11/10_333.pdf.

² Article 5(6) third subparagraph of the CRA Regulation “*In order to take account of developments on financial markets, the Commission shall adopt, by means of delegated acts in accordance with Article 38a, and subject to the conditions of Articles 38b and 38c, measures to specify further or amend the criteria set out in points (a), (b) and (c) of the second subparagraph of this paragraph.*”

³ Minor differences between the two tests are indicated in paragraphs 30(b), 31 and 147 and 148 of the Annex III.

6 Proposed updated Guidelines on Endorsement

21. This section provides an overview of the proposed updated Guidelines on Endorsement and describes the obligations stemming from the CRA Regulation that an endorsing CRA should be fulfilling on an ongoing basis. Each section of the Guidelines on Endorsement is presented below along with the reasoning for the approach taken by ESMA. In particular, the updated Guidelines on Endorsement focus on points (b)-(e) of Article 4(3) of the CRA Regulation. This is because these points, unlike points (a), (f), (g), and (h), create ongoing obligations on the endorsing CRA in addition to the initial conditions which are assessed by ESMA before a CRA begins endorsing credit ratings. This section is structured as follows:

- Requirements relating to point (b) of Article 4(3)
- Requirements relating to points (c)-(d) of Article 4(3)
- Requirements relating to point (e) of Article 4(3)
- General requirements

6.1 Requirements relating to point (b) of Article 4(3)

Article 4(3)(b): *"the credit rating agency has verified and is able to demonstrate on an ongoing basis to the European Supervisory Authority (European Securities and Markets Authority) (ESMA) established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council (1), that the conduct of the credit rating activities by the third-country credit rating agency resulting in the issuing of the credit rating to be endorsed fulfils requirements which are at least as stringent as the requirements set out in Articles 6 to 12 and Annex I, with the exception of Articles 6a, 6b, 8a, 8b, 8c and 11a, point (ba) of point 3 and points 3a and 3b of Section B of Annex I;"*

22. On the basis of the 2011 Guidelines on Endorsement, ESMA has so far assumed that a third-country CRA was fulfilling the requirement in point (b), when the third-country CRA complied with the rules and regulations of the third country whose local legal and regulatory system was deemed by ESMA to impose "requirements as stringent as those found in Articles 6 to 12 and Annex I, with the exception of Articles 6a, 6b, 8a, 8b, 8c and 11a, point (ba) of point 3 and points 3a and 3b of Section B of Annex I of the EU Regulation". This was reflected in paragraphs 20, 22 and 24 of the 2011 Guidelines on Endorsement.

Extract from the 2011 Guidelines on Endorsement

20. ESMA will apply Article 4 (3) (b) by requiring that the local legal and regulatory system imposes requirements as stringent as those found in Articles 6 to 12 of the EU Regulation. This interpretation is adopted by ESMA taking into account the European Commission Service's view on this subject that it has been communicated.

22. *ESMA is of the view that Article 4 (3) (f) requires the CRA to be authorised or registered, and subject to supervision, in the third country, therefore the requirements “as stringent as the requirements set out in Articles 6 to 12” of the Regulation must be established by law or regulation, and not on a self-imposed basis. In fact, it seems inconsistent to require a third country to have a regulatory system which provides for authorisation/registration and supervision of the CRAs, when the requirements “as stringent as” could be met on a self-imposed basis.*

24. *The Regulation does not envisage admissibility of a dual system of compliance with its requirements, whereby local legal/regulatory duties in a third country would be “topped up” by policies and procedures voluntarily followed by the third country CRA or the EU-registered, endorsing CRA. Therefore, the requirements as stringent as those set out in Articles 6 to 12 may only be established in law or regulation of that third-country in order to satisfy the condition laid down in Article 4 (3) (b).*

23. However, this approach has had a number of unintended consequences. First, the obligation of the endorsing CRA to verify and demonstrate fulfilment of the requirement by the third-country CRA has been difficult to implement in practice, since expertise regarding the law of the third country would typically lie with the third-country CRA. Second, the approach has limited ESMA’s ability to exercise its supervisory powers provided in points (b) and (c) of the CRA Regulation i.e. monitoring and assessing compliance of the third-country CRA.
24. This has resulted in the situation, which was not foreseen by the legislator, where the requirements imposed on endorsed ratings have in practice been nearly indistinguishable from those imposed on credit ratings entering the EU market through the equivalence regime. Equivalence is a separate third-country regime provided for in the CRA Regulation, which, unlike the endorsement regime, is reserved for credit ratings relating to non-EU instruments and entities, and limited to credit ratings and credit rating activities that are not of systemic importance to the financial stability or integrity of the financial markets of one or more Member States. Where the equivalence regime implies a strong reliance on the third country supervisor, the endorsement regime provides for ESMA to be able to monitor and assess the conduct of the third-country CRA through the endorsing CRA.
25. For these reasons, the proposed updated Guidelines on Endorsement entail that ESMA will no longer consider it sufficient proof of fulfilment of the requirements in point (b) that the third-country CRA complies with the rules of the third country. Instead, ESMA expects that the endorsing CRA has verified and is able to demonstrate that the third-country CRA has established internal requirements which are at least as stringent as the corresponding EU requirements. ESMA, furthermore, expects that the endorsing CRA has verified and is able to demonstrate that the conduct of the third-country CRA fulfils the internal requirements set out by the third-country CRA in practice.
26. This change in approach may have a limited impact on groups of CRAs with global policies and procedures, provided that these are fulfilled in a uniform manner across jurisdictions. To the extent that there are differences between the policies and procedures of an EU

CRA and of a third-country CRA and/or the way in which these policies and procedures are being fulfilled, the endorsing CRA will need to carry out additional work to ensure compliance. ESMA will carry out compliance checks of the conduct of the third-country CRA in the course of its ongoing supervisory activities in accordance with its risk-based approach.

27. As explained in the section 4 “*Overview of the phases of the endorsement process*” ESMA will also continue to carry out an assessment of a third-country legal and supervisory framework as a precondition for endorsement. This assessment will no longer conclude that the requirements of the third country are “as stringent as” the relevant EU requirements but merely that they meet a minimum threshold of investor protection and financial stability. ESMA assesses this requirement based on the updated Methodological Framework provided in Annex III.
28. ESMA also continues to require an endorsing CRA to put in place measures to monitor the conduct of the third-country CRA as described in section 4.2. The proposed updated Guidelines on Endorsement provide further clarification on the nature of these measures.

Proposed updated Guidelines

29. ESMA considers that compliance of the third-country CRA with the third-country legal and supervisory framework does not in and of itself prove that the third-country CRA is fulfilling requirements which are “as stringent as” the requirements set out in Articles 6 to 12 and Annex I of the CRA Regulation with the exception of Articles 6a, 6b, 8a, 8b, 8c and 11a, point (ba) of point 3 and points 3a and 3b of Section B of Annex I of the CRA Regulation (hereinafter “the relevant provisions of the CRA Regulation”). Instead, ESMA expects that the endorsing CRA has verified and is able to demonstrate that the third-country CRA has established internal requirements which are at least as stringent as the corresponding requirements in the relevant provisions of the CRA Regulation. ESMA, furthermore, expects that the endorsing CRA has verified and is able to demonstrate that the conduct of the third-country CRA fulfils the internal requirements set out by the third-country CRA in practice and on an ongoing basis.
30. The endorsing CRA does not need to demonstrate that the third-country CRA has established internal requirements which are as stringent as the relevant EU requirements when the third-country CRA directly fulfils the requirements set out in the relevant provisions of the CRA Regulation. In this case, ESMA only expects that the endorsing CRA verifies and is able to demonstrate that the conduct of the third-country CRA fulfils the relevant EU requirements in practice.
31. To be able to fulfil the requirements described above, ESMA expects that the endorsing CRA has put in place measures to monitor the policies and procedures as well as the conduct of the third-country CRA. Such measures should, as a minimum, include the following:
 - (a) Assessment of policies and procedures of the third-country CRA: An initial assessment of the relevant policies and procedures in the third-country CRA

should be carried out to ensure that they meet the requirements in Article 4(3)(b) of the CRA Regulation. Any subsequent material changes to the relevant policies and procedures in the third-country CRA should also be reviewed and assessed.

(b) Ongoing monitoring of the conduct of the third-country CRA by the endorsing CRA should include:

- i. monitoring of relevant documents produced by the internal control functions within the third-country CRA, including but not limited to reports from compliance, internal audit, risk management, the Board and the review function;
- ii. basic checks of every endorsed credit rating to ensure the relevant requirements are met with regard to conflicts of interests, methodologies, disclosures etc; and
- iii. periodical deep-dive assessments of the compliance of a sample of endorsed credit ratings with specific requirements or areas of requirements.

32. The endorsing CRA should ensure that the above-described measures are based on appropriate and effective organisational and administrative arrangements and clear decision-making procedures, which allocate roles and responsibilities.

33. Whenever the endorsing CRA finds that the conduct of the third-country CRA may not fulfil requirements which are as stringent as the relevant provisions of the CRA Regulation, ESMA expects that the endorsing CRA takes appropriate steps. Such steps should be proportionate and may include:

- (a) requesting clarification from the third-country CRA;
- (b) taking appropriate remedial action;
- (c) suspending endorsement of new ratings which may be affected by the potential breach;
- (d) withdrawing outstanding endorsed ratings which may be affected by the potential breach; and
- (e) informing ESMA.

Question 1: Please indicate what you believe will be the impact of ESMA's change in approach, if any, on the groups of CRAs currently benefiting from the endorsement regime? Please explain your reasoning.

Question 2: Please indicate whether you consider the measures which the endorsing CRA should have in place to monitor the conduct of the third-country CRA will adequately ensure the quality and independence of endorsed credit ratings?

6.2 Requirements relating to points (c)-(d) of Article 4(3)

Article 4(3)(c): *“the ability of ESMA to assess and monitor the compliance of the credit rating agency established in the third country with the requirements referred to in point (b) is not limited;”*

Article 4(3)(d): *“the credit rating agency makes available on request to ESMA all the information necessary to enable ESMA to supervise on an ongoing basis the compliance with the requirements of this Regulation;”*

34. Through its supervisory activity, ESMA has noticed that, paragraph 34 of the 2011 Guidelines on Endorsement has been misinterpreted by some stakeholders as suggesting that ESMA would not exercise its powers under points (c) and (d) of the CRA Regulation.

34. [...] ESMA should also be able to collect information concerning the conduct of the third country CRA from the relevant supervisory authority, in the framework of the cooperation arrangements provided for by Article 4(3) (h).

35. While ESMA may request information about the conduct of the third-country CRA from the third-country supervisor in accordance to article 4(3)(h), ESMA is also empowered to request such information directly from the endorsing CRA in accordance with Article 4(3)(c) and (d) .

36. In order to remove any doubt relating to ESMA’s supervisory powers to request information and its ability to assess and monitor the compliance of the third-country CRA provided in points (c) and (d) of Article 4(3), clarification is provided in the updated Guidelines on Endorsement.

37. The Guidelines clarify that ESMA, in accordance with Article 4(3)(c), may require that an endorsing CRA provides information about the conduct of a third-country CRA on an ad-hoc or periodical basis. Periodical information could include errors identified in methodologies (c.f. Article 8(7)(a) of the CRA Regulation) and the information listed in Subsection II *“periodical disclosures”* of Section E of Annex I of the CRA Regulation.

Proposed updated Guidelines

38. With regard to point (c) of Article 4(3) of the CRA Regulation, the endorsing CRA should make available to ESMA, on an ad-hoc or periodical basis, any information which ESMA may need in order to be able to assess and monitor the compliance of the third-country CRA with the requirements laid down in Article 4(3)(b).

39. If the endorsing CRA identifies any factors outside of its control which may create limitations to ESMA’s ability to assess and monitor the compliance of the third-country CRA, for example resulting from third-country legislation, ESMA expects that the endorsing CRA informs ESMA without undue delay.

40. With regard to point (d) of Article 4(3) of the CRA Regulation, when requested, in order to supervise EU CRAs on an ongoing basis, ESMA expects that the endorsing CRA provides any relevant information relating to the conduct of the third-country CRA.

Question 3: Do you agree with ESMA's understanding of points (c) and (d) of Article 4(3) of the CRA Regulation?

6.3 Requirements relating to point (e) of Article 4(3)

Article 4(3)(e): *"There is an objective reason for the credit rating to be elaborated in a third country;"*

41. ESMA takes this opportunity to clarify what ESMA considers to be an objective reason within the meaning of Article 4(3)(e) without excluding the possibility that there may be other reasons which will be assessed by ESMA on a case by case basis. It is, furthermore, clarified that ESMA expects CRAs to document the objective reason for each endorsed rating.

Proposed updated Guidelines

42. ESMA considers it to be an "objective reason" within the meaning of Article 4(3)(e) where the rated entity or instrument is established or issued in the third country where the rating is elaborated. ESMA will assess other reasons presented by CRAs on a case-by-case basis.
43. The endorsing CRA should notify ESMA when the objective reasons for elaborating endorsed credit ratings outside the EU, deviate from those indicated to ESMA pursuant Annex XI of the RTS on Registration. To be able to fulfil this requirement and to allow ESMA to assess the objective reason for individual ratings, ESMA expects that the endorsing CRA documents the objective reason for each endorsed credit rating.

Question 4: In your view, are there other reasons which should be considered "objective reasons" within the meaning of Article 4(3)(e)? If so, please indicate them providing reasons.

6.4 General requirements

44. ESMA highlights the EU CRA's obligation to ensure that all conditions for endorsement are met at all time and to notify ESMA, as appropriate, of any material changes to the initial conditions of registration relating to endorsement. The updated Guidelines on Endorsement, furthermore, refer to certain reporting obligations which are provided in ESMA's existing Guidelines on Periodical Information and which are relevant for the fulfilment of the conditions for endorsement.

Proposed updated Guidelines

45. ESMA expects that the compliance function of the endorsing CRA monitors and verifies, on an ongoing basis, that all the conditions for endorsement remain fulfilled. As a good

practice, the internal audit function should regularly review the control environment for endorsement.

46. As stated in Section 5.12 of the Guidelines on Periodic Information, ESMA considers a “material change” to be any change in the information submitted in the registration application and, more generally, any change that may affect compliance with the requirements of the CRA Regulation. As a result, ESMA expects that the endorsing CRA notifies ESMA of any changes to the documentation provided in accordance with Annex XI of the RTS on registration which meets these conditions.
47. ESMA, furthermore, expects that the endorsing CRA reports periodically on the fulfilment of the conditions for endorsement in accordance with the Guidelines on Periodic Information, including
 - (a) information on internal complaints submitted to the compliance department (section 5.4);
 - (b) independent non-executive directors’ opinions and reports submitted to the Board (section 5.5);
 - (c) potential and actual cases of non-compliance with the requirements for endorsing ratings that have been identified and measures taken (section 5.7); and
 - (d) reports from compliance, internal audit, risk management (section 5.9).

Question 5: Do you agree that the endorsing CRA should comply with the general requirements as listed in this section?

Annex I: Summary of questions

Q1	Please indicate what you believe will be the impact of ESMA's change in approach, if any, on the groups of CRAs currently benefiting from the endorsement regime? Please explain your reasoning.
Q2	Please indicate whether you consider the measures which the endorsing CRA should have in place to monitor the conduct of the third-country CRA will adequately ensure the quality and independence of endorsed credit ratings?
Q3	Do you agree with ESMA's understanding of points (c) and (d) of Article 4(3) of the CRA Regulation?
Q4	In your view, are there other reasons which could be considered "objective" within the meaning of Article 4(3)(e)? If so, please indicate which providing reasons.
Q5	Do you agree that the endorsing CRA should comply with the general requirements as listed in this section?

Annex II: Proposed updated guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation

1 Scope

Who?

1. These guidelines apply to credit rating agencies established in the Union and registered with ESMA (hereinafter “EU CRAs”) in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies⁴ (hereinafter “CRA Regulation”) which are endorsing or which intend to endorse credit ratings issued by a third-country CRA in accordance with Article 4(3) of the same Regulation.

What?

2. These guidelines apply to credit ratings issued in third countries and endorsed pursuant to Article 4(3) of the CRA Regulation. These guidelines repeal the “*Guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation No 1060/2009*” published by ESMA on 18 May 2011 (ESMA/2011/139).

When?

3. These guidelines will enter into force 1 June 2018.

⁴ OJ L 302, 17.11.2009, p.1.

2 Definitions, legislative references and acronyms

The following definitions apply:

ESMA	European Securities and Markets Authorities
CRA Regulation	Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit ratings agencies as amended by Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011, Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011, Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013, and Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014
CRA 2	Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation (EC) No 1060/2009 on credit rating agencies
CRA 3	Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies
ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (ESMA Regulation)
RTS on Registration	Commission delegated regulation (EU) No 449/2012 of 21 March 2012 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards on information for registration and certification of credit rating agencies
Guidelines on Periodic Information	Guidelines on periodic information to be submitted to ESMA by Credit Rating Agencies (ESMA/2015/609) adopted in June 2015
EU CRA	A credit rating agency registered with ESMA.
Endorsing CRA	An EU CRA which endorses or has endorsed one or more credit ratings in accordance with Article 4(3) of the CRA Regulation.
Third country CRA	A CRA which is registered and subject to supervision in a non-EU country.
Group of CRAs	As per Article 3(1)(m) of the CRA Regulation 'group of CRAs' means a group of undertakings established in the Union consisting of a parent undertaking and its subsidiaries within the meaning of Articles 1 and 2 of Directive 83/349/EEC as well as undertakings linked to each other by

	a relationship within the meaning of Article 12(1) of Directive 83/349/EEC and whose occupation includes the issuing of credit ratings. For the purposes of Article 4(3)(a), a group of credit rating agencies shall also include credit rating agencies established in third countries;
The relevant provisions of the CRA Regulation	The provisions quoted in Article 4(3)(b) of the CRA Regulation: Articles 6 to 12 and Annex I of the CRA Regulation with the exception of Articles 6a, 6b, 8a, 8b, 8c and 11a, point (ba) of point 3 and points 3a and 3b of Section B of Annex I of the CRA Regulation.

3 Purpose

4. The CRA Regulation entered into force on 7 December 2009. The amendments introduced by CRA 2 empowered ESMA to undertake the supervision of all credit rating agencies in the European Union. The amendments introduced by CRA 3 created a set of new requirements for EU CRAs. These new requirements will enter into force for the purposes of endorsement of credit ratings issued in third countries on 1 June 2018.
5. Article 21(3) requires ESMA, in cooperation with EBA and EIOPA, to issue and update guidelines on the application of the endorsement regime under Article 4(3) of the Regulation, in accordance with Article 16 of the ESMA Regulation. In order to fulfil the requirements placed upon it by Article 21(3), ESMA is updating the Guidelines on Endorsement published on 18 May 2011.
6. With these guidelines ESMA aims to bring clarity about the conditions for endorsement laid down in points (b), (c), (d), and (e) of Article 4(3) of the CRA Regulation.

4 Compliance and reporting obligations

4.1 Status of the guidelines

7. This document contains guidelines pursuant to Article 16 of the ESMA Regulation and Article 21(2) of the CRA Regulation. In accordance with Article 16(3) of the ESMA Regulation, CRAs must make every effort to comply with the guidelines.

4.2 Reporting requirements

8. ESMA will assess the application of these guidelines by the CRAs through its ongoing supervision and monitoring of CRAs' periodic reporting to ESMA.

5 Guidelines on the application of Article 4(3)

9. An EU CRA should not begin endorsing credit ratings, before ESMA has completed two separate assessments concluding that the conditions laid down in Article 4(3) of the CRA Regulation are fulfilled: (1) assessment of the conditions relating to the legal and supervisory framework of the third country and (2) assessment of the conditions relating to the CRAs intending to endorse credit ratings.
10. Similarly, an EU CRA should not endorse credit ratings if it becomes aware that the conditions initially assessed by ESMA are no longer fulfilled.

Requirements relating to Article 4(3)(b)

11. ESMA considers that compliance of the third-country CRA with the third-country legal and supervisory framework does not in and of itself prove that the third-country CRA is fulfilling requirements which are “as stringent as” the requirements set out in Articles 6 to 12 and Annex I of the CRA Regulation with the exception of Articles 6a, 6b, 8a, 8b, 8c and 11a, point (ba) of point 3 and points 3a and 3b of Section B of Annex I of the CRA Regulation (hereinafter “the relevant provisions of the CRA Regulation”). Instead, ESMA expects that the endorsing CRA has verified and is able to demonstrate that the third-country CRA has established internal requirements which are at least as stringent as the corresponding requirements in the relevant provisions of the CRA Regulation. ESMA, furthermore, expects that the endorsing CRA has verified and is able to demonstrate that the conduct of the third-country CRA fulfils the internal requirements set out by the third-country CRA in practice and on an ongoing basis.
12. The endorsing CRA does not need to demonstrate that the third-country CRA has established internal requirements which are as stringent as the relevant EU requirements if the third-country CRA chooses to directly fulfil the requirements set out in the relevant provisions of the CRA Regulation. In this case, ESMA only expects that the endorsing CRA verifies and is able to demonstrate that the conduct of the third-country CRA fulfils the relevant EU requirements in practice.
13. To be able to fulfil the requirements described above, ESMA expects that the endorsing CRA has put in place measures to monitor the policies and procedures as well as the conduct of the third-country CRA. Such measures should, as a minimum, include the following:
 - (a) Assessment of policies and procedures of the third-country CRA: An initial assessment of the relevant policies and procedures in the third-country CRA should be carried out to ensure that they meet the requirements in Article 4(3)(b) of the CRA Regulation. Any subsequent material changes to the relevant policies and procedures in the third-country CRA should also be reviewed and assessed.
 - (b) Ongoing monitoring of the conduct of the third-country CRA by the endorsing CRA should include:

- i. monitoring of relevant documents produced by the internal control functions within the third-country CRA, including but not limited to reports from compliance, internal audit, risk management, the Board and the review function;
 - ii. basic checks of every endorsed credit rating to ensure the relevant requirements are met with regard to conflicts of interests, methodologies, disclosures etc; and
 - iii. periodical deep-dive assessments of the compliance of a sample of endorsed credit ratings with specific requirements or areas of requirements.
14. The endorsing CRA should ensure that the above-described measures are based on appropriate and effective organisational and administrative arrangements and clear decision-making procedures, which allocate roles and responsibilities.
15. Whenever the endorsing CRA finds that the conduct of the third-country CRA may not fulfil requirements which are as stringent as the relevant provisions of the CRA Regulation, ESMA expects that the endorsing CRA takes appropriate steps. Such steps should be proportionate and may include:
 - (a) requesting clarification from the third-country CRA;
 - (b) taking appropriate remedial action;
 - (c) suspending endorsement of new ratings which may be affected by the potential breach
 - (d) withdrawing outstanding endorsed ratings which may be affected by the potential breach; and
 - (e) informing ESMA.

Requirements relating to Article 4(3)(c)-(d)

16. With regard to point (c) of Article 4(3) of the CRA Regulation, the endorsing CRA should make available to ESMA, on an ad-hoc or periodical basis, any information which ESMA may need in order to be able to assess and monitor the compliance of the third-country CRA with the requirements laid down in Article 4(3)(b).
17. If the endorsing CRA identifies any factors outside of its control which may create limitations to ESMA's ability to assess and monitor the compliance of the third-country CRA, for example resulting from third-country legislation, ESMA expects that the endorsing CRA informs ESMA without undue delay.

18. With regard to point (d) of Article 4(3) of the CRA Regulation, when requested, in order to supervise EU CRAs on an ongoing basis, ESMA expects that the endorsing CRA provides any relevant information relating to the conduct of the third-country CRA .

Requirements relating to Article 4(3)(e)

19. ESMA considers it to be an “objective reason” within the meaning of Article 4(3)(e) where the rated entity or instrument is established or issued in the third country where the rating is elaborated. ESMA will assess other reasons presented by CRAs on a case-by-case basis.
20. The endorsing CRA should notify ESMA when the objective reasons for elaborating endorsed credit ratings outside the EU, deviate from those indicated to ESMA pursuant Annex XI of the RTS on Registration. To be able to fulfil this requirement and to allow ESMA to assess the objective reason for individual ratings, ESMA expects that the endorsing CRA documents the objective reason for each endorsed credit rating.

General requirements

21. ESMA expects that the compliance function of the endorsing CRA monitors and verifies, on an ongoing basis, that all the conditions for endorsement remain fulfilled. As a good practice, the internal audit function should regularly review the control environment for endorsement.
22. As stated in Section 5.12 of the Guidelines on Periodic Information, ESMA considers a “material change” to be any change in the information submitted in the registration application and, more generally, any change that may affect compliance with the requirements of the CRA Regulation. As a result, ESMA expects that the endorsing CRA notifies ESMA of any changes to the documentation provided in accordance with Annex XI of the RTS on registration which meets these conditions.
23. ESMA, furthermore, expects that the endorsing CRA reports periodically on the fulfilment of the conditions for endorsement in accordance with the Guidelines on Periodic Information, including
 - (a) information on internal complaints submitted to the compliance department (section 5.4);
 - (b) independent non-executive directors’ opinions and reports submitted to the Board (section 5.5);
 - (c) potential and actual cases of non-compliance with the requirements for endorsing ratings that have been identified and measures taken (section 5.7); and
 - (d) reports from compliance, internal audit, risk management (section 5.9).

Annex III: Updated Methodological Framework

Background

1. On the basis of a mandate provided by the Commission, ESMA's legal predecessor, CESR, developed in 2010 a Methodological Framework for assessing third-country legal and supervisory frameworks for the purposes of equivalence in accordance with Article 5(6) of the CRA Regulation (hereinafter "the Methodological Framework"). In that mandate, the Commission committed to a procedure whereby it would take its decision on equivalence based on a technical advice from CESR (now ESMA). The mandate and the Methodological Framework were published as a part of a technical advice to the Commission on equivalence of the Japanese legal and supervisory framework for CRAs ("the 2010 Technical Advice")⁵. ESMA has relied on the Methodological Framework published in the 2010 Technical Advice for all the technical advice on equivalence it has carried out in accordance with Article 5(6) of the CRA Regulation⁶.
2. The following year, ESMA published its 2011 Guidelines on Endorsement which clarified that ESMA would carry out assessments of third-country legal and supervisory frameworks as a precondition for endorsement in accordance with points (b), (f), and (g) of Article 4(3) of the CRA Regulation. It was, furthermore, clarified that such assessments would be carried out using the Methodological Framework developed in the 2010 Technical Advice. An excerpt of the 2010 Technical Advice with the Methodological Framework was included as an annex to the final report of the 2011 Guidelines on Endorsement.
3. The update of the Guidelines on Endorsement proposed in this Consultation Paper has mainly been driven by the need to update the Methodological Framework to reflect the changes to Articles 6-12 and Annex I of the CRA Regulation introduced by CRA 3.
4. However, the following new provisions introduced by CRA 3 were explicitly excluded from the scope of Article 4(3)(b) and Article 5(6) of the CRA Regulation: 6a, 6b, 8a, 8b, 8c and 11a, point (ba) of point 3 and points 3a and 3b of Section B of Annex I. The rationale for excluding these provisions from the endorsement assessment is provided in recital 48 of CRA 3: "*Some of the provisions introduced by this regulation should not apply to the equivalence and endorsement assessments. This is the case for those provisions that only establish obligations on issuers but not on credit rating agencies. In addition, provisions that relate to the structure of the credit rating market within the Union rather*

⁵ "Technical Advice to the Commission on the Equivalence between the Japanese Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies" Date: 9th June 2010, Ref.: CESR/10- 333 available at https://www.esma.europa.eu/sites/default/files/library/2015/11/10_333.pdf. See section 1.2 of the attached mandate "*Mechanism for assessing the equivalence*". The relevant section of the letter can be found on page 228 of

⁶ The Commission has the power to specify further or amend the criteria for assessing equivalence lies in accordance with Article 5(6) third subparagraph of the CRA Regulation. At the date of adoption of this consultation paper, the Commission had not exercised this power. However, the Methodological Framework presented in this Annex is without prejudice to any future delegated act the Commission may choose to adopt in accordance with Article 5(6) third subparagraph of the CRA Regulation.

than establishing rules of conduct for credit rating agencies should not be considered in this context.”

5. In addition, the following provisions have not been taken into account in the update of the Methodological Framework:
 - (a) **Article 8d:** Whilst Article 8d of the CRA Regulation is not explicitly excluded from the scope of Articles 4(3)(b) and 5(6), ESMA considers that it should not be taken into account. As Article 8d “*only establish[es] obligations on issuers but not on credit rating agencies*” it is not relevant for the purposes of third-country assessments as stated in recital 48 of CRA 3.
 - (b) **Provisions relating to sovereign ratings:** Article 8a establishes requirements relating to sovereign ratings and is among the Articles which are explicitly excluded from the scope of Article 4(3)(b) and Article 5(6) of the CRA Regulation. CRA 3 does not explicitly exclude Annex I section D part III of the CRA Regulation, which relates to Article 8a, from the scope of Article 4(3)(b) and 5(6) of the CRA Regulation. However, ESMA has not taken this part of Annex I into account as it considers that it cannot be read independently of Article 8a.
6. The material changes to the Methodological Framework are summarised in the table below. ESMA has not changed the criteria for assessing any of the requirements pre-dating CRA 3. For the purposes of equivalence and endorsement, these changes will only enter into force 1 June 2018. In the interest of readability and clarity, the following changes have been made to the document:
 - (a) the document now refers to third-country assessments for the purposes of endorsement as well as equivalence (the previous document only addressed equivalence) – the only difference between the two assessments are set out in paragraphs 30(b), 31 and 147 and 148;
 - (b) references to the national competent authorities in charge of supervising credit ratings in the EU prior to the establishment of ESMA have been deleted;
 - (c) references to the 2010 equivalence assessment of Japan have been deleted;
 - (d) the background sections (sections 1-3) have been shortened and their headings simplified; and
 - (a) references to CESR have been replaced with a reference to ESMA.

Table: Overview of material changes made to the Methodological Framework

ID	Changes to the CRA Regulation introduced by CRA 3	Addressed in the updated methodology:
1	<p>Amended Provision Article 6(1) and 6(3)</p> <p>1. A credit rating agency shall 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 agency issuing the credit rating or the rating outlook, its shareholders, managers, rating analysts, employees or any other natural person whose services are placed at the disposal or under the control of the credit rating agency, or any person directly or indirectly linked to it by control.</p> <p>[...]</p> <p>3. At the request of a credit rating agency, ESMA may exempt a credit rating agency from complying with the requirements of points 2, 5, 6 and 9 of Section A of Annex I and Article 7(4) if the credit rating agency is able to demonstrate that those 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 that: [...]</p>	<p>62. These requirements involve the need for CRAs to:</p> <p>(a) identify and eliminate or alternatively manage and disclose conflicts of interest including those relating to shareholders of the CRA;</p> <p>[...]</p> <p>70. However, ESMA can accept the following differences:</p> <p>[...]</p> <p>(e) The requirement mentioned in point (f) of paragraph 62 above. ESMA accepts that thresholds in a third country may be different or that the third-country legislation does not explicitly address shareholders requirements. However, the third-country laws and regulations should provide sufficient protection against the risk that the interests of a significant shareholder impacts on the independence of the CRA, its analysts and/or its credit ratings/rating outlooks.</p>
2	<p>New Provision Article 6(4)</p> <p>4. Credit rating agencies shall establish, maintain, enforce and document an effective internal control structure governing the implementation of policies and procedures to prevent and mitigate possible conflicts of interest and to ensure the independence of credit ratings, rating analysts and rating teams regarding shareholders, administrative and management bodies and sales and marketing activities. Credit rating agencies shall establish standard operating procedures (SOPs) with regard to corporate governance, organisation, and the management of conflicts of interest. They shall periodically monitor and review those SOPs in order to evaluate their effectiveness and assess whether they should be updated.</p>	<p>62. These requirements involve the need for CRAs to:</p> <p>[...]</p> <p>(n) establish, maintain, enforce and document an effective internal control structure governing the implementation of policies and procedures to prevent and mitigate possible conflicts of interest and to ensure the independence of credit ratings, rating analysts and rating teams regarding shareholders, administrative and management bodies and sales and marketing activities.</p>
3	<p>Amended Provision Article 7(5)</p> <p>5. Compensation and performance evaluation of employees involved in the credit rating activities or rating outlooks, as well as persons approving the credit ratings or rating outlooks, shall not be contingent on the amount of revenue that the credit rating agency derives from the rated entities or related third parties.</p>	<p>Not incorporated as change since it is not considered substantial</p>

4	<p>Amended Provision Article 8(2) 2. A credit rating agency shall adopt, implement and enforce adequate measures to ensure that the credit ratings and the rating outlooks it issues are based on a thorough analysis of all the information that is available to it and that is relevant to its analysis according to the applicable rating methodologies. It shall adopt all necessary measures so that the information it uses in assigning credit ratings and rating outlooks is of sufficient quality and from reliable sources. The credit rating agency shall issue credit ratings and rating outlooks stipulating that the rating is the agency's opinion and should be relied upon to a limited degree."</p>	<p>126. In addition, according to Article 8(2), 8(2a), 10(2)-(2a) and paragraphs (1), (2), (4) of Section D of Annex I of the CRA Regulation, CRAs should ensure that the following information is indicated in the credit ratings or rating outlooks: [...] (i) a statement that an issued credit rating or rating outlook is the agency's opinion and should be relied upon to a limited degree.</p> <p>127. [...] However, ESMA can accept the following differences for the purposes of endorsement or equivalence: [...] (e) points (h) and (i) of paragraph 126 may be achieved by means other than an explicit legal requirement;</p>
5	<p>New Provision Article 8(2a) 2a. Changes in credit ratings shall be issued in accordance with the credit rating agency's published rating methodologies.</p>	<p>126. In addition, according to Article 8(2), 8(2a), 10(2)-(2a) and paragraphs (1), (2), (4) of Section D of Annex I of the CRA Regulation, CRAs should ensure that the following information is indicated in the credit ratings or rating outlooks: [...] (j) if the credit rating constitutes a change of an existing credit rating it should be issued in accordance with the CRA's published rating methodologies.</p>
6	<p>Amended Provision Article 8(5) 5. A credit rating agency shall monitor credit ratings and review its credit ratings and methodologies on an ongoing basis and at least annually, in particular where material changes occur that could have an impact on a credit rating. A credit rating agency shall establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings.</p> <p>Sovereign ratings shall be reviewed at least every six months.</p>	<p>Not incorporated as it relates to sovereign ratings</p>
7	<p>New Article 8(5a) 5a. A credit rating agency that intends to make a material change to, or use, new rating methodologies, models or key rating assumptions which could have an impact on a credit rating shall publish the proposed material changes or proposed new rating methodologies on its website inviting stakeholders to submit comments for a period of one month together with a detailed explanation of the reasons for and the implications of the proposed material changes or proposed new rating methodologies.</p>	<p>114. These requirements impose an obligation on CRAs to: (d) publish any proposed material changes or proposed new rating methodologies on its website inviting stakeholders to submit comments for a period of one month together with a detailed explanation of the reasons for and the implications of the proposed material changes or proposed new rating methodologies; [...]</p>

		115. ESMA considers that these requirements are significant in ensuring that the CRA is able to achieve the overall objective of these requirements. However, ESMA does not expect identical requirements to be hard-wired into a third-country regulatory framework. In particular, ESMA may accept that points (d)-(g) are not in place if the third-country supervisory and legal framework ensures an adequate level of quality, rigour and transparency of rating methodologies through other means.
8	<p>New Provision Article 8(6aa-ab)</p> <p>6. Where rating methodologies, models or key rating assumptions used in credit rating activities are changed in accordance with Article 14(3), a credit rating agency shall:</p> <p>(a) immediately, using the same means of communication as used for the distribution of the affected credit ratings, disclose the likely scope of credit ratings to be affected;</p> <p>(aa) immediately inform ESMA and publish on its website the results of the consultation and the new rating methodologies together with a detailed explanation thereof and their date of application;</p> <p>(ab) immediately publish on its website the responses to the consultation referred to in paragraph 5a except in cases where confidentiality is requested by the respondent to the consultation;</p>	<p>114. These requirements impose an obligation on CRAs to</p> <p>(e) immediately inform the competent supervisor and publish on its website the results of the consultation and the new rating methodologies together with a detailed explanation thereof and their date of application;</p> <p>(f) immediately publish on its website the responses to the consultation relating to changes in rating methodologies except in cases where confidentiality is requested by the respondent to the consultation;</p> <p>[...]</p> <p>115. ESMA considers that these requirements are significant in ensuring that the CRA is able to achieve the overall objective of these requirements. However, ESMA does not expect identical requirements to be hard-wired into a third-country regulatory framework. In particular, ESMA may accept that points (d)-(g) are not in place if the third-country supervisory and legal framework ensures an adequate level of quality, rigour and transparency of rating methodologies through other means.</p>
9	<p>New Provision Article 8(7)</p> <p>7. Where a credit rating agency becomes aware of errors in its rating methodologies or in their application it shall immediately:</p> <p>(a) notify those errors to ESMA and all affected rated entities explaining the impact on its ratings including the need to review issued ratings</p> <p>(b) where errors have an impact on its credit ratings, publish those errors on its website;</p> <p>(c) correct those errors in the rating methodologies; and</p> <p>(d) apply the measures referred to in points (a), (b) and (c) of paragraph 6.</p>	<p>114. These requirements impose an obligation on CRAs to</p> <p>(g) notify identified errors in methodologies to the supervisor and all affected rated entities explaining the impact on its ratings including the need to review issued ratings; where errors have an impact on its credit ratings, publish those errors on its website; and correct those errors in the rating methodologies.</p> <p>[...]</p> <p>115. ESMA considers that these requirements are significant in ensuring that the CRA is able to achieve the overall objective of these requirements. However, ESMA does not expect identical requirements to be hard-wired into a third-country regulatory</p>

		framework. In particular, ESMA may accept that points (d)-(g) are not in place if the third-country supervisory and legal framework ensures an adequate level of quality, rigour and transparency of rating methodologies through other means.
10	<p>New Provision Article 8d Article 8d Use of multiple credit rating agencies</p> <p>1. Where an issuer or a related third party intends to appoint at least two credit rating agencies for the credit rating of the same issuance or entity, the issuer or a related third party shall consider appointing at least one credit rating agency with no more than 10 % of the total market share, which can be evaluated by the issuer or a related third party as capable of rating the relevant issuance or entity, provided that, based on ESMA's list referred to in paragraph 2, there is a credit rating agency available for rating the specific issuance or entity. Where the issuer or a related third party does not appoint at least one credit rating agency with no more than 10 % of the total market share, this shall be documented.</p> <p>2. With a view to facilitating the evaluation by the issuer or a related third party under paragraph 1, ESMA shall annually publish on its website a list of registered credit rating agencies, 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.</p> <p>3. For the purposes of this Article, total market share shall be measured with reference to annual turnover generated from credit rating activities and ancillary services, at group level.</p>	Not incorporated as it “only establish[es] obligations on issuers but not on credit rating agencies” (Recital 48).
11	<p>Amended Provision Article 10(1) and (2)</p> <p>1. A credit rating agency shall disclose any credit rating or rating outlook, as well as any decision to discontinue a credit rating, on a non-selective basis and in a timely manner. In the event of a decision to discontinue a credit rating, the information disclosed shall include full reasons for the decision.</p> <p>The first subparagraph shall also apply to credit ratings that are distributed by subscription.</p> <p>2. Credit rating agencies shall ensure that credit ratings and rating outlooks are presented and processed in accordance with the requirements set out in Section D of Annex I and shall not present factors other than those related to the credit ratings.</p>	<p>125. Namely, pursuant to Article 10(1), (4), (5), (6) Article 11(2), and paragraph (5) of Section D of Annex I of the CRA Regulation, CRAs are required to:</p> <p>(g) in presenting credit ratings or rating outlooks, avoid presenting factors other than those related to the credit ratings.</p> <p>127. However, ESMA can accept the following differences for the purposes of endorsement or equivalence:</p> <p>[...]</p> <p>(f) point (g) of paragraph 125 may be achieved by other means, for example through a general requirement that the presentation of the credit rating may not be misleading.</p>
12	New Provision Article 10(2a)	89. According to Article 10(2a) of the CRA Regulation, credit ratings, rating outlooks and information relating thereto, shall be

	<p>2a. Until disclosure to the public of credit ratings, rating outlooks and information relating thereto, they shall be deemed to be inside information as defined in, and in accordance with, Directive 2003/6/EC.</p> <p>Article 6(3) of that Directive shall apply mutatis mutandis to credit rating agencies as regards their duty of confidentiality and their obligation to maintain a list of persons who have access to their credit ratings, rating outlooks or related information before disclosure.</p> <p>The list of persons to whom credit ratings, rating outlooks and information relating thereto are communicated before being disclosed shall be limited to persons identified by each rated entity for that purpose.</p>	<p>treated as inside information, until the moment when they have been disclosed to the public.</p> <p>90. ESMA considers these requirements to be very important for the reasons set out above, and it expects the objectives of these requirements to be met for the purposes of assessing equivalence.</p>
13	<p>Amended Provision Article 10(5)</p> <p>5. When a credit rating agency issues an unsolicited credit rating, it shall state prominently in the credit rating whether or not the rated entity or related third party participated in the credit rating process and, using a clearly, distinguishable different colour code for the rating category, whether the credit rating agency had access to the accounts, management and other relevant internal documents of the rated entity or a related third party.</p>	<p>125. Namely, pursuant to Article 10(1), (4), (5), (6) Article 11(2), and paragraph (5) of Section D of Annex I of the CRA Regulation, CRAs are required to:</p> <p>(d) [...] whilst required by the CRA Regulation, it is not necessary that it is a legal requirement in the third country that the latter is indicated using a clearly, distinguishable different colour code for the rating category;</p>
14	<p>Amended provisions, Annex I, Section B, paragraph 1</p> <p>1. A credit rating agency shall identify, eliminate, or manage and disclose, clearly and prominently, any actual or potential conflicts of interest that may influence the analyses and judgments of its rating analysts, employees, or any other natural person whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in credit rating activities and persons approving credit ratings and rating outlooks.</p>	<p>Not incorporated as change not considered substantial</p>
15	<p>Amended provisions, Annex I, Section B, paragraph 3(aa)-(ca)</p> <p>3. A credit rating agency shall not issue a credit rating or a rating outlook in any of the following circumstances, or shall, in the case of an existing credit rating or rating outlook, immediately disclose where the credit rating or rating outlook is potentially affected by the following:</p> <p>(a) the credit rating agency or persons referred to in point 1, directly or indirectly owns financial instruments of the rated entity or a related third party or has any other direct or indirect ownership interest in that entity or party, other than holdings in diversified collective investment schemes, including managed funds such as pension funds or life insurance;</p> <p>(aa) a shareholder or member of a credit rating agency holding 10 % or more of either the capital or the voting rights of that credit rating agency or being otherwise in a position to exercise significant influence on the business activities of the credit</p>	<p>62. These requirements involve the need for CRAs to:</p> <p>[...]</p> <p>(f) not issue a credit rating or in the case of an existing credit rating, immediately disclose that the credit rating is potentially affected in the circumstances set out in Annex 1 Section B paragraph 3 of the CRA Regulation for example situations where a shareholder holding 10 % or more of either the capital or the voting rights of that CRA or being otherwise in a position to exercise significant influence on the business activities of the CRA is also a significant shareholder or a board member of the rated entity;</p> <p>70. However, ESMA can accept the following differences:</p> <p>[...]</p>

	<p>rating agency, holds 10 % or more of either the capital or the voting rights of the rated entity or of a related third party, or of any other ownership interest in that rated entity or third party, excluding holdings in diversified collective investment schemes and managed funds such as pension funds or life insurance, which do not put him in a position to exercise significant influence on the business activities of the scheme;</p> <p>(b) the credit rating is issued with respect to the rated entity or a related third party directly or indirectly linked to the credit rating agency by control;</p> <p>(c) a person referred to in point 1 is a member of the administrative or supervisory board of the rated entity or a related third party; or</p> <p>(ca) a shareholder or member of a credit rating agency holding 10 % or more of either the capital or the voting rights of that credit rating agency or being otherwise in a position to exercise significant influence on the business activities of the credit rating agency, is a member of the administrative or supervisory board of the rated entity or a related third party;</p> <p>(d) a rating analyst who participated in determining a credit rating, or a person who approved a credit rating, has had a relationship with the rated entity or a related third party which may cause a conflict of interests.</p> <p>A credit rating agency shall also immediately assess whether there are grounds for re-rating or withdrawing the existing credit rating or rating outlook.</p>	<p>(e) the requirement mentioned in point (f) of paragraph 62 above. ESMA accepts that thresholds in a third country may be different or that the third-country legislation does not explicitly address shareholders requirements. However, the third-country laws and regulations should provide sufficient protection against the risk that the interests of a significant shareholder impacts on the independence of the CRA, its analysts and/or its credit ratings/rating outlooks.</p>
16	<p>New provision Annex I, Section B, paragraph 3c</p> <p>3c. A credit rating agency shall ensure that fees charged to its clients for the provision of credit rating 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.</p>	<p>120. According to paragraph 3c of Section B of Annex I of the CRA Regulation, a CRA should ensure that fees charged to its clients for the provision of credit rating 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 CRA or on any other result or outcome of the work performed. If this requirement is not in place, ESMA considers that there should be other safeguards to ensure that the objectives of avoiding conflicts of interests and promoting fair competition are achieved.</p>

17	<p>Amended provision Annex I, Section B, paragraph 4</p> <p>4. Neither a credit rating agency nor any person holding, directly or indirectly, at least 5 % of either the capital or voting rights of the credit rating agency or being otherwise in a position to exercise significant influence on the business activities of the credit rating agency shall provide consultancy or advisory services to the rated entity or a related third party regarding the corporate or legal structure, assets, liabilities or activities of that rated entity or related third party.</p>	<p>63. In addition to the above:</p> <p>(a) a CRA as well as individuals and entities, who are in a position to exercise significant influence on the business activities of a CRA are prohibited from providing consultancy or advisory services to a rated entity or a related third party;</p>
18	<p>New provision Annex I, Section C, paragraphs 7-8</p> <p>7. A person referred to in point 1 shall not take up a key management position with the rated entity or a related third party within six months of the issuing of a credit rating or rating outlook.</p> <p>8. For the purposes of Article 7(4):</p> <p>(a) credit rating agencies shall ensure that the lead rating analysts shall not be involved in credit rating activities related to the same rated entity or a related third party for a period exceeding four years;</p> <p>(b) credit rating agencies other than those appointed by an issuer or a related third party and all credit rating agencies issuing sovereign ratings shall ensure that:</p> <p>(i) the rating analysts shall not be involved in credit rating activities related to the same rated entity or a related third party for a period exceeding five years;</p> <p>(ii) the persons approving credit ratings shall not be involved in credit rating activities related to the same rated entity or a related third party for a period exceeding seven years.</p> <p>The persons referred to in points (a) and (b) of the first subparagraph shall not be involved in credit rating activities related to the rated entity or a related third party referred to in those points within two years of end of the periods set out in those points.’;</p>	<p>Not incorporated as change not considered substantial</p> <p>This requirement reduces the scope of an existing obligation rather than creating a new obligation.</p>
19	<p>New provision Annex I, Section D, Subsection I paragraph 2(f) And second subparagraph</p> <p>2. A credit rating agency shall ensure that at least:</p> <p>[...]</p> <p>(f) in the case of a rating outlook, the time horizon is provided during which a change in the credit rating is expected.</p> <p>When publishing credit ratings or rating outlooks, credit rating agencies shall include a reference to the historical default rates published by ESMA in a central</p>	<p>126. In addition, according to Article 8(2), 8(2a), 10(2)-(2a) and paragraphs (1), (2), (4) of Section D of Annex I of the CRA Regulation, CRAs should ensure that the following information is indicated in the credit ratings or rating outlooks:</p> <p>[...]</p> <p>(h) a reference to the historical default rates together with an explanatory statement of the meaning of those default rates;</p>

	<p>repository in accordance with Article 11(2), together with an explanatory statement of the meaning of those default rates.</p>	<p>127. [...] However, ESMA can accept the following differences for the purposes of endorsement or equivalence: [...] (e) points (h) and (i) of paragraph 126 may be achieved by means other than an explicit legal requirement;</p>
20	<p>Amended provision Annex I, Section D, Subsection I paragraph 2a 2a. A credit rating agency shall accompany the disclosure of rating methodologies, models and key rating assumptions with guidance which explains assumptions, parameters, limits and uncertainties surrounding the models and rating methodologies used in credit ratings, including simulations of stress scenarios undertaken by the credit rating agency when establishing the credit ratings, credit rating information on cash-flow analysis it has performed or is relying upon and, where applicable, an indication of any expected change in the credit rating. Such guidance shall be clear and easily comprehensible.</p>	<p>128. Finally, the entry into force of CRA 3 has expanded the scope of two disclosure requirements in Section D of Annex I, which were previously limited to structured financed instruments: (a) Paragraph 2a, a CRA should accompany the disclosure of methodologies, models and key rating assumptions with guidance explaining the assumptions, parameters, limits and uncertainties surrounding the models and methodologies used in such credit ratings as well as any expected change of the credit rating;</p>
21	<p>Amended provision Annex I, Section D, Subsection I paragraph 3 3. The credit rating agency shall inform the rated entity during working hours of the rated entity and at least a full working day before publication of the credit rating or the rating outlook. That information shall include the principal grounds on which the credit rating or rating outlook is based in order to give the rated entity an opportunity to draw attention of the credit rating agency to any factual errors.</p>	<p>107. These requirements are set out in Articles 8(2), 8(5), 10(2), and part I of Section D of Annex of the CRA Regulation. These requirements are: [...] (d) to inform the entity subject to the rating during working hours of the rated entity and at least a full working day before publication of the credit rating including the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the CRA to any factual errors; [...] 111. In respect of the requirement set out in paragraph 107 d) above, ESMA does not consider it necessary that there is a specific requirement that the CRA to inform the rated entity at least a full working day before the publication of a credit rating. Other timeframes may be acceptable as long as the CRA provides to the rated entity with the opportunity to draw attention to possible factual errors.</p>
22	<p>Amended provision Annex I, Section D, Subsection I paragraph 6 6. A credit rating agency shall disclose on its website, and notify ESMA on an ongoing basis, information about all entities or debt instruments submitted to it for their initial review or for preliminary rating. Such disclosure shall be made whether or not issuers contract with the credit rating agency for a final rating.</p>	<p>128. Finally, the entry into force of CRA 3 has expanded the scope of two disclosure requirements in Section D of Annex I, which were previously limited to structured financed instruments: [...] (b) paragraph 6, a CRA shall disclose on its website, and notify ESMA on an ongoing basis, information about all entities or debt</p>

		<p>instruments submitted to it for their initial review or for preliminary rating. Such disclosure shall be made whether or not issuers contract with the CRA for a final rating</p> <p>129. An important objective of the requirement in paragraph 128(b) above is to limit the risk of rating shopping. This objective may be achieved through other means.</p>
23	<p>New provision Annex I, Section D, Subsection III</p> <p>III. Additional obligations in relation to sovereign ratings</p> <p>1. Where a credit rating agency issues a sovereign rating or a related rating outlook, it shall simultaneously provide a detailed research report explaining all the assumptions, parameters, limits and uncertainties and any other information taken into account in determining that sovereign rating or rating outlook. That report shall be publicly available, clear and easily comprehensible.</p> <p>2. A publicly available research report accompanying a change compared to the previous sovereign rating or related rating outlook shall include at least the following:</p> <p>(a) a detailed evaluation of the changes to the quantitative assumption justifying the reasons for the rating change and their relative weight. The detailed evaluation should include a description of the following: per capita income, GDP Growth, inflation, fiscal balance, external balance, external debt, an indicator for economic development, an indicator for default and any other relevant factor taken into account. This should be complemented with the relative weight of each factor;</p> <p>(b) a detailed evaluation of the changes to the qualitative assumption justifying the reasons for the rating change and their relative weight;</p> <p>(c) a detailed description of the risks, limits and uncertainties related to the rating change; and</p> <p>(d) a summary of minutes of the meeting of the rating committee that decided on the rating change.</p> <p>3. Without prejudice to point 3 of Part I of Section D of Annex I, where a credit rating agency issues sovereign ratings or related rating outlooks, it shall publish them in accordance with Article 8a, after the close of business hours of regulated markets and at least one hour before their opening.</p> <p>4. Without prejudice to point 5 of Part I of Section D of Annex I, in accordance with which, when announcing a credit rating, a credit rating agency is to explain in its press releases or reports the key elements underlying the credit rating and although national policies may serve as an element underlying a sovereign rating, policy recommendations, prescriptions or guidelines to rated entities, including States or</p>	<p>Not incorporated as it relates to sovereign ratings</p>

	regional or local authorities of States, shall not be part of sovereign ratings or rating outlooks.	
24	<p>New provision Annex I, Section E, Subsection II</p> <p>(a) list of fees charged to each client for individual credit ratings and any ancillary services;</p> <p>(aa) its pricing policy, including the fees structure and pricing criteria in relation to credit ratings for different asset classes; and [...]</p>	<p>141. Article 11(3) and paragraph (2) of Part II of Section E of Annex I of the CRA Regulation require CRAs to provide, on an annual basis, to the competent authority:</p> <p>[...]</p> <p>(c) the pricing policy, including the fees structure and pricing criteria in relation to credit ratings for different asset classes.</p> <p>142. ESMA expects the third-country legal and supervisory framework to impose some form of disclosure requirement regarding revenue generation by the CRA and that the third-country supervisor has the power to request all the information listed above.</p>
25	<p>New provision Annex I, Section E, Subsection III, paragraph 3</p> <p>III. Transparency report</p> <p>A credit rating agency shall make available annually the following information: [...]</p> <p>3. statistics on the allocation of its staff to new credit ratings, credit rating reviews, methodology or model appraisal and senior management, and on the allocation of staff to rating activities with regard to the different asset classes (corporate — structured finance — sovereign);</p>	<p>145. In addition, under Article 12 and Part III of Section E of Annex I of the CRA Regulation, CRAs are required to make the following information available to the public on an annual basis in an annual report on their internet website:</p> <p>[...]</p> <p>(e) statistics on the allocation of their staff to new credit ratings, credit rating reviews, methodologies or model appraisals and senior management, and on the allocation of staff to rating activities with regard to the different asset classes (corporate — structured finance — sovereign); and [...]</p> <p>146. Whilst according to the CRA Regulation these requirements need to be disclosed to the public, ESMA considers disclosure to the authority is adequate. In addition, ESMA considers that it can accept that CRAs are not required to disclose the statistics referred to under letter e) in paragraph 145 above.</p>
26	<p>Amended provision Annex I, Section E, Subsection III, paragraph 7</p> <p>III. Transparency report</p> <p>A credit rating agency shall make available annually the following information: [...]</p> <p>7. financial information on the revenue of the credit rating agency, including total turnover, divided into fees from credit rating and ancillary services with a comprehensive description of each, including the revenues generated from</p>	<p>145. In addition, under Article 12 and Part III of Section E of Annex I of the CRA Regulation, CRAs are required to make the following information available to the public on an annual basis in an annual report on their internet website:</p> <p>[...]</p> <p>(g) financial information on the revenue of the credit rating agency, including total turnover, divided into fees from credit rating</p>

	<p>ancillary services provided to clients of credit rating services and the allocation of fees to credit ratings of different asset classes. Information on total turnover shall also include a geographical allocation of that turnover to revenues generated in the Union and revenues worldwide.</p>	<p>and ancillary services with a comprehensive description of each, including the revenues generated from ancillary services provided to clients of credit rating services and the allocation of fees to credit ratings of different asset classes. Information on total turnover shall also include a geographical allocation of that turnover to revenues generated in the Union and revenues worldwide</p> <p>146. Whilst according to the CRA Regulation these requirements need to be disclosed to the public, ESMA considers disclosure to the authority is adequate. [...] The level of detail concerning the disclosures mentioned in letter g) do not need to be identical to the EU requirements.</p>
27	<p>Transversal: Rating Outlooks The requirements to credit ratings are extended to cover rating outlooks as well. The words and/or “rating outlook” have thus been added after the words “credit rating” in the following provisions:</p> <p>Provisions quoted above Article 6(1); Article 7(5); Article 8(2); Article 10(1), (2) and (2a); Annex I, Section B, paragraph 1 and 3; Annex I, Section C, paragraph 7; Annex I, Section D, Subsection I, paragraph 2(f) and 3; and Annex I, Section D, Subsection III, paragraphs 1-4.</p> <p>Annex I, Section B, paragraph 7 7. A credit rating agency shall arrange for adequate records and, where appropriate, audit trails of its credit rating activities to be kept. Those records shall include: (a) for each credit rating and rating outlook decision, the identity of the rating analysts participating in the determination of the credit rating or rating outlook, the identity of the persons who have approved the credit rating or rating outlook, information as to whether the credit rating was solicited or unsolicited, and the date on which the credit rating action was taken; (b) the account records relating to fees received from any rated entity or related third party or any user of ratings; (c) the account records for each subscriber to the credit ratings or related services; (d) the records documenting the established procedures and rating methodologies used by the credit rating agency to determine credit ratings and rating outlooks</p>	<p>32. While the CRA Regulation provides a definition of a rating outlook in Article 3(1)(w), ESMA may accept that no such explicit definition is provided in a third-country legal framework. However, rating outlooks should be covered by the same safeguards that ensure the quality, independence, timely disclosure and confidentiality of credit ratings.</p>

(e) the internal records and files, including non-public information and work papers, used to form the basis of any credit rating and rating outlook decision taken;

Annex I, Section C, paragraphs 2 and 3(b)

2. No person referred to in point 1 shall participate in or otherwise influence the determination of a credit rating or rating outlook of any particular rated entity if that person:

- (a) owns financial instruments of the rated entity, other than holdings in diversified collective investment schemes;
- (b) owns financial instruments of any entity related to a rated entity, the ownership of which may cause or may be generally perceived as causing a conflict of interest, other than holdings in diversified collective investment schemes;
- (c) has had a recent employment, business or other relationship with the rated entity that may cause or may be generally perceived as causing a conflict of interest.

3. Credit rating agencies shall ensure that persons referred to in point 1:

[...]

(b) do not disclose any information about credit ratings, possible future credit ratings or rating outlooks of the credit rating agency, except to the rated entity or a related third party;

[...]

**Annex I, Section D, Subsection I, paragraphs 1, 2(a), and 2(d)
Section D Rules on the presentation of credit ratings and rating outlooks**

I. General obligations

1. A credit rating agency shall ensure that any credit rating and rating outlook states clearly and prominently the name and job title of the lead rating analyst in a given credit rating activity and the name and position of the person primarily responsible for approving the credit rating or rating outlook.

2. A credit rating agency shall ensure that at least:

- (a) all substantially material sources, including the rated entity or, where appropriate, a related third party, which were used to prepare the credit rating or rating outlook are indicated together with an indication as to whether the credit rating or rating outlook has been disclosed to that rated entity or related third party and amended following that disclosure before being issued;

[...]

(d) the date at which the credit rating was first released for distribution and when it was last updated including any rating outlooks is indicated clearly and prominently [...]

Annex I, Section D, Subsection I, paragraphs 4 and 5

4. A credit rating agency shall state clearly and prominently when disclosing credit ratings or rating outlooks any attributes and limitations of the credit rating or rating outlook. In particular, a credit rating agency shall prominently state when disclosing any credit rating or rating outlook whether it considers satisfactory the quality of information available on the rated entity and to what extent it has verified information provided to it by the rated entity or a related third party. If a credit rating or a rating outlook involves a type of entity or financial instrument for which historical data is limited, the credit rating agency shall make clear, in a prominent place, such limitations.

In a case where the lack of reliable data or the complexity of the structure of a new type of financial instrument or the quality of information available is not satisfactory or raises serious questions as to whether a credit rating agency can provide a credible credit rating, the credit rating agency shall refrain from issuing a credit rating or withdraw an existing rating.

5. When announcing a credit rating or a rating outlook, a credit rating agency shall explain in its press releases or reports the key elements underlying the credit rating or the rating outlook.

Annex I, Section E, Subsection I, paragraph 3

A credit rating agency shall generally disclose the fact that it is registered in accordance with this Regulation and the following information:

[...]

3. the policy of the credit rating agency concerning the publication of credit ratings and other related communications including rating outlooks;

Methodological Framework for assessing third-country legal and supervisory frameworks for the purposes of endorsement and equivalence (Article 4(3) and Article 5(6) of the CRA Regulation)

1 ESMA's approach to assessing a third-country legal and supervisory framework

7. The CRA Regulation has established a strict EU legal and supervisory framework for CRAs in order to ensure that credit ratings are independent, objective, and of adequate quality in order to underpin confidence and stability in the financial markets and contribute to the protection of investors.
8. ESMA recognises that, in contrast to legal and supervisory frameworks in some third countries, the EU legal and supervisory framework for CRAs is very prescriptive and detailed.
9. As such, ESMA's approach to assessing a third-country legal and supervisory framework is not to expect the EU regime to be adopted in an identical manner – this would be unrealistic and does not reflect the principle that the same outcome can be achieved through different means.
10. The adopted approach is to take a high-level and overall look at the legal and supervisory framework that is in place, the powers of those entrusted to enforce it, and their overall approach to supervision.
11. In adopting this approach, ESMA has taken into account the Commission mandate⁷ requesting ESMA Technical advice for equivalence. The mandate clarifies that for the purposes of assessing a third country legal and supervisory framework: ***“the priority should lie in assuring that users of ratings in the EU would benefit from equivalent protections in terms of CRA's integrity, transparency, good governance and reliability of the credit rating activities.”***
12. That mandate also made it clear that ESMA should:
 - (a) conduct a technical “*global and holistic*” assessment of the regulatory framework based on “*the entirety of the third country regulatory framework in that country*”;
 - (b) “*not be limited to just assessing a commitment to any international convergence initiatives*” – such as the IOSCO code of conduct;

⁷ Published as a part of CESR's “*Technical Advice to the European Commission on the Equivalence between the Japanese Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies*” Date: 9th June 2010, Ref.: CESR/10- 333 available at https://www.esma.europa.eu/sites/default/files/library/2015/11/10_333.pdf see pages 226-234.

(c) “focus on the differences between the regulatory regime established at EU level and the third country framework”, and “evaluate and give its judgment on the material importance of such differences.”

13. Consequently, in conducting its assessment, ESMA does not just look at the relevant legal provisions that have been introduced for the purposes of regulating and supervising CRAs in a third country, but also looks at other areas, such as existing securities or corporate law that may also be applicable.
14. As the assessment is global in nature and not limited to the legal requirements that may be in place, ESMA assesses in accordance with the mandate also the nature of supervision and enforcement to which a CRA may be subjected.

2 General conditions for assessing a third-country legal and supervisory framework

15. In order to ensure that ESMA adopts an objective approach to its assessment, it has established a number of general principles that it considers have to be met by third-country legal and supervisory frameworks and third-country supervisory authorities:
 - (a) Pure self-regulatory regimes are considered insufficient. Any assessment of a third-country legal and supervisory framework must be based on laws, draft laws and regulations that either are currently or will be legally binding;
 - (b) For the assessment of a third-country legal and supervisory regime, it is not sufficient that the relevant rules are described in the abstract. The third-country supervisor has to provide not only with the relevant rules and regulations themselves, but also with accompanying translations into English as the functional language of ESMA;
 - (c) Unconditional assessments can only be made with regard to laws and regulations which have already entered into force. Where only draft regulations and laws exist, an assessment can only be made under the condition that the draft regulations and laws will come into force as proposed. If significant changes occur, the assessment will need to be revised;
 - (d) The third-country legal and regulatory framework needs to provide legal clarity regarding what a CRA is, or the activities that it conducts are, and these need to broadly cover what the CRA Regulation covers, including those areas where exemptions are permissible according to the third-country laws and regulations. Such exemptions need to be considered in order to verify that they do not hamper the compliance with the objectives of the CRA Regulation.
16. In addition, Articles 4(3) and 5(6) of the CRA Regulation set out the following requirements that need to be met cumulatively by a third-country legal and supervisory framework in order for it to be able to be considered as equivalent or as meeting the initial requirements for endorsement:
 - (a) CRAs in the third country are subject to authorisation or registration (Article 4(3)(f) and 5(6)(b));

- (b) the regulatory regime in the third country prevents interference with the content of credit ratings and methodologies by the supervisory authorities and other public authorities of that third country (Article 4(3)(g) and 5(6)(c));
 - (c) CRAs in the third country are subject to legally binding rules which correspond to those set out in Articles 6 to 12 and Annex I with the exception of Articles 6a, 6b, 8a, 8b, 8c and 11a, point (ba) of point 3 and points 3a and 3b of Section B of Annex I of the CRA Regulation (Article 4(3)(b) and 5(6)(b));
 - (d) CRAs in the third country are subject to (effective) supervision (and enforcement) on an ongoing basis (Article 4(3)(f) and 5(6)(a)).
17. The conditions listed in paragraphs 16 a), b) and paragraph 15 d) above are narrowly defined in the CRA Regulation itself and as such can be assessed with relative ease. If one of the following conditions is not met by a third-country regulatory system, i.e:
- (a) in terms of scope there is no legal clarity regarding what a CRA is, or the activities that it conducts are, and the scope of coverage is not broadly speaking what is covered by the CRA Regulation;
 - (b) CRAs in third countries are not subject to authorisation or registration; or
 - (c) the regulatory regime in the third country does not prevent interference by the supervisory authorities and other public authorities of that third country with the content of credit ratings and methodologies;
- then ESMA will consider that the third-country legal and supervisory framework does not meet the conditions for equivalence and the initial conditions for endorsement.**
18. As regards, the conditions set out in paragraph 16 c) and d) , ESMA considers that this condition requires that the third-country legal framework reflect the core substantive provisions of the CRA Regulation concerning the detailed criteria listed in section 4 of this Annex.
19. This means that a third-country legal and supervisory framework may still be considered as meeting the conditions for equivalence and the initial conditions for endorsement if the legal and supervisory system achieves similar regulatory effects in practice, notwithstanding differences in the supervisory approach or legal framework.

3 Interaction with the supervisor of the third country under assessment

20. As a first step, ESMA liaises with the relevant third-country supervisor and asks it to complete an assessment table comparing the two regulatory frameworks.
21. This self-assessment completed by the third-country supervisor enables ESMA to analyse the provisions of the two frameworks side by side, identifying any similarities or differences

on a provision by provision basis in order to establish how the objectives are covered, either by law, through supervisory practice or a combination of the two.

22. In assessing the third-country legal and supervisory framework, ESMA will at all times have regard for whether the third-country legal and supervisory framework for CRAs ensures that: ***“users of ratings in the EU would benefit from equivalent protections in terms of CRA’s integrity, transparency, good governance and reliability of the credit rating activities.”***⁸
23. If ESMA is not satisfied that the third-country framework is reaching the objective mentioned above, then a positive conclusion of the assessment cannot be reached.
24. In areas where ESMA considers that there is no corresponding third-country provision, ESMA will highlight this difference and provide suggestions to the third-country supervisor as to how the gap between the frameworks could be bridged.
25. Although it is not possible to take proposals that may be adopted in the future into account, where such proposals may be a useful guide as to the direction of travel of an existing framework, reference to this should be made.
26. Once the assessment of each provision has been completed, ESMA asks if the requirement that is in place in the third-country achieves the same objective as the EU requirement. A conclusion is then reached in respect of each provision.
27. ESMA then groups the provisions into core areas establishing overall objectives for each area and then assesses whether or not the overall objectives of each of these areas were met.

⁸ Section 2.3 in the Mandate from the Commission: Brussels, 12 June 2009 | MARKET/G3/MTF/mg Ares (2009). Letter addressed to Mr Eddy Wymeersch Chairman Committee of European Securities Regulators (CESR). Subject: Request for CESR technical advice on the equivalence between certain third country legal and supervisory frameworks and the EU Regulatory Regime for credit rating agencies. Published as a part of CESR’s *“Technical Advice to the European Commission on the Equivalence between the Japanese Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies”* Date: 9th June 2010, Ref.: CESR/10- 333 available at https://www.esma.europa.eu/sites/default/files/library/2015/11/10_333.pdf.

4 Detailed criteria for assessing a third-country legal and supervisory framework

28. For the purposes of this assessment, ESMA has grouped the requirements from the CRA Regulation into different sections depending on the objective each provision seeks to address. These sections are discussed in further detail below and are as follows:

4.1. Scope of the regulatory and supervisory framework

4.2. Corporate governance

4.3. Conflicts of interest management

4.4. Organisational requirements

4.4.1. General organisational requirements

4.4.2. Outsourcing

4.4.3. Confidentiality

4.4.4. Record Keeping

4.5. Quality of methodologies and quality of ratings

4.5.1. Reviewing credit ratings, methodologies, models and assumptions and information used in issuing ratings

4.5.2. Knowledge and experience of employees directly involved in credit rating activities

4.5.3. Quality of credit ratings and analysis of information used in assigning credit ratings

4.5.4. Quality of methodologies and changes to them

4.5.5. Competition

4.6. Disclosure

4.6.1. Presentation and disclosure of credit ratings

4.6.2. General and periodic disclosure about the CRA

4.7. Effective supervision and enforcement

4.7.1. The methods that the third-country authority has in place to ensure that it is adequately staffed

4.7.2. Powers of the third country authority

4.7.3. Sanctions

4.1 Scope of the Regulatory and supervisory framework

29. Ensuring that the nature of the legal and supervisory framework in place is able to meet the same overall objectives as the EU regulatory regime is key. If ESMA is not satisfied that the framework is able to do this, then a positive conclusion of the assessment cannot be reached.
30. As such, the following needs to be in place to meet the initial requirements for endorsement or equivalence:
 - (a) there has to be some form of legally binding regulatory and supervisory framework for CRAs in place (Articles 4(3)(b) and 5(6)(b) of the CRA Regulation);
 - (b) CRAs have to be subject to what ESMA considers to be effective ongoing supervision and enforcement (for what ESMA considers this to be see sub-section (4.7) *Effective Supervision and Enforcement* below (Articles 4(3)(f) and 5(6)(a) of the CRA Regulation) – for the purposes of endorsement, ESMA may accept less effective supervision than for the purposes of equivalence this is due to a difference in the wording of Articles 4(3)(f) and 5(6)(a) of the CRA Regulation;
 - (c) CRAs are subject to some form of registration or authorisation process (Articles 4(3)(f) and 5(6)(a) of the CRA Regulation);
 - (d) the scope of the activities of a CRA that are subject to the third-country legal and supervisory framework includes the scope of activities that is included in the EU regime (Article 3(1)(a), (b) and (w) of the CRA Regulation);
 - (e) the relevant authority is prohibited from influencing the content of ratings and methodologies (Articles 4(3)(g) and 5(6)(c) of the CRA Regulation).
31. In respect of the points above, point b) is further developed in subsection 4.7 below regarding what ESMA considers needs to be in place for effective ongoing supervision and enforcement.
32. Of the other requirements set out in paragraph 29 above, it is point d) that needs further elaboration below. There needs to be legal clarity regarding what a CRA is, or the activities that it conducts are, and these need to broadly cover what the CRA Regulation covers. While the CRA Regulation provides a definition of a rating outlook in Article 3(1)(w), ESMA may accept that no such explicit definition is provided in a third-country legal framework. However, rating outlooks should be covered by the same safeguards that ensure the quality, independence, timely disclosure and confidentiality of credit ratings.
33. Where exemptions are permissible according to third-country laws and regulations, such exemptions need to be considered in order to verify that they do not hamper the compliance with the objectives of the CRA Regulation.
34. Looking at the requirements of the CRA Regulation, this means that the definition of a CRA or the activities that it conducts do not need to be identical, but they need to cover the same scope of what is covered by the CRA Regulation, ensuring that the credit ratings

that are subject to the oversight of the third-country regulatory framework in question and that could be used in the EU are covered.

35. ESMA will look at the legal definition of what a CRA is, what activities of the agency are covered and also at the nature of the exemptions that can be applied.
36. In looking at the definition of a CRA, ESMA will consider whether or not the definition means that individuals as opposed to legal entities could be considered as CRAs, as this could have implications for the recourse of those relying on those ratings.
37. A definition of CRAs, which is broader in scope than the EU definition, is acceptable for the purposes of endorsement and equivalence.
38. ESMA points out that a third-country legal and supervisory framework may not require all CRAs to be registered or authorised with the relevant authority, but only those that want to enable their ratings to be used for what ESMA considers to be those circumstances covered by Article 4(1) of the CRA Regulation (referred to as “use for regulatory purposes” in this document) need to be registered or authorised.
39. ESMA highlights that Articles 4 and 5 of the CRA Regulation make specific reference to the use of credit ratings issued in a third country for regulatory purposes in the EU and require the CRA in question to be registered or authorised in that third country.
40. In addition, ESMA highlights that it does not expect the concept of “use for regulatory purposes” in a third-country legal and supervisory framework to be the same.
41. In cases where the third-country legal and supervisory framework is broad, although ESMA has been mandated to assess the third-country framework as a whole, for the purposes of equivalence and endorsement, ESMA is only focusing on those aspects of the third country framework that relate to the use of credit ratings for “regulatory purposes”.

Exemptions

42. In terms of assessing the exemptions that can be applied and how the authority in question exercises its discretion in respect of these exemptions, any exemptions need to be assessed for the following reasons.
43. If there are no exemptions set out in the third-country legal and supervisory framework, then this is acceptable for the purposes of equivalence and endorsement because, the exemptions allowed under the CRA Regulation exist in order to facilitate competition, recognising that the nature, scale, and complexity of a CRA’s business and the nature and range of its credit ratings, may in certain circumstances warrant that the agency can be exempted from complying with some of the CRA Regulation’s requirements.
44. Where exemptions are allowed, ESMA looks at what the nature of these exemptions are or can be, looking at whether it is ensured that:

“users of ratings in the EU would benefit from equivalent protections in terms of CRA’s integrity, transparency, good governance and reliability of the credit rating activities.”⁹

45. ESMA must be satisfied that the exemptions do not prevent the achievement of this objective in practice, and there is legal clarity as to how the authority will exercise its discretion in respect of applying exemptions for attaining registered or authorisation status.

4.2 Corporate governance

46. Corporate governance is a core aspect of the CRA Regulation, and its ability to achieve the objective set out in paragraph 7 above, and as such sets out a large number of detailed and prescriptive requirements in Section A of Annex I of the CRA Regulation.

47. ESMA considers that the key objectives of the CRA Regulation’s requirements with respect to corporate governance are to ensure that senior management is responsible and legally accountable for ensuring:

- (a) that credit ratings activities are independent;
- (b) that there is proper management of conflicts of interest; and
- (c) compliance with the legal requirements of the regulatory framework.

48. ESMA points out that, as set out in recitals 28, 29 and 30 of the CRA Regulation, corporate governance arrangements are necessary to ensure that credit ratings are independent, objective, and of adequate quality.

49. The CRA Regulation sets out a number of corporate governance requirements that need to be in place in order to ensure that a CRA is able to demonstrate its ability to meet these objectives, and its compliance with them.

50. In assessing the equivalence of a third-country legal and supervisory framework, ESMA assesses whether the requirements set out in Article 6(2) and Section A of Annex I of the CRA Regulation are in place.

51. These requirements involve the need for a CRA to have:

- (a) an administrative or supervisory board (“board”);
- (b) at least 2 independent members of the board tasked with monitoring the:
 - i. credit rating policy;
 - ii. effectiveness of the internal quality control system;

⁹ Section 2.3 in the Mandate from the European Commission: Brussels, 12 June 2009 | MARKT/G3/MTF/mg Ares (2009). Letter addressed to Mr Eddy Wymeersch Chairman Committee of European Securities Regulators (CESR). Subject: Request for CESR technical advice on the equivalence between certain third country legal and supervisory frameworks and the EU Regulatory Regime for credit rating agencies. Published as a part of CESR’s “*Technical Advice to the European Commission on the Equivalence between the Japanese Regulatory and Supervisory Framework and the EU Regulatory Regime for Credit Rating Agencies*” Date: 9th June 2010, Ref.: CESR/10- 333 available at https://www.esma.europa.eu/sites/default/files/library/2015/11/10_333.pdf.

iii. internal controls and measures established to deal with conflicts of interest.

52. These requirements also involve the need for a CRA to ensure that:

- (a) the compensation of the independent members of the board is not linked to the business performance of the CRA, and that their judgment can be exercised in an independent manner;
- (b) the term of office of the independent members of the administrative or supervisory board is for a pre-agreed fixed period and is not renewable;
- (c) a term limit for the independent member of the board is defined;
- (d) the majority of members of the board, including independent members have sufficient expertise in financial services;
- (e) if the CRA issues credit ratings of structured finance instruments, at least one independent member and one other member of the board has in-depth knowledge and experience at a senior level of the markets in structured finance instruments;
- (f) in addition to the overall responsibility of the board, the independent members of the administrative or supervisory board have the specific task of monitoring:
 - i. development of credit rating policy;
 - ii. development of the methodologies the CRA uses in credit rating activities;
 - iii. effectiveness of internal control mechanisms in relation to credit rating activities;
 - iv. effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or adequately managed and disclosed;
 - v. compliance and governance processes including the efficiency of the review function.

53. ESMA anticipates that there may be significant differences in the corporate governance requirements in a third country, and as such is not expecting all of the above requirements to be in place.

54. However, ESMA considers that for the purposes of assessing equivalence and the initial conditions for endorsement, there needs to be some form of requirement that a corporate governance structure is in place to ensure that senior management is accountable.

55. In respect of the requirements relating to the independent directors that are tasked with monitoring certain activities, ESMA considers that what is important and needs as a minimum to be in place is that there is a clear allocation of the following monitoring tasks in terms of overall responsibility to the senior management:

- (a) the development of credit rating policy and of the methodologies used by the CRA in its credit rating activities;
- (b) effectiveness of the internal quality control system;

- (c) effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or managed and disclosed;
 - (d) compliance and governance processes.
56. ESMA points out that it considers that these monitoring tasks do not need to be carried out by senior management per se, but in order for the objective of the EU requirement to be met, what is important is that these monitoring tasks are carried out by someone independent, who is not involved in credit rating activities, and whose compensation is arranged in such a way to ensure the independence of their judgment and the absence of links to the business performance of the CRA.
57. Considering the importance of the specific monitoring tasks and the overall responsibilities of senior management, these tasks and functions are to be ideally carried out by those who have sufficient expertise in financial services and, where relevant for the business of the CRA, an appropriate in-depth knowledge and experience of the markets in structured finance instruments.

4.3 Conflicts of interest management

58. ESMA points out that conflicts of interest management is a core requirement of the CRA Regulation in order to ensure that it meets the overall objective.
59. ESMA considers the objectives of the conflicts of interest management requirements of the CRA Regulation are to ensure:
- (a) objectivity, independence, integrity, and quality of the credit ratings;
 - (b) transparency about the credit ratings; and
 - (c) the protection of investors and financial markets.
60. The CRA Regulation sets out a number of detailed requirements that have to be met by CRAs in order to ensure that these objectives are achieved.
61. In assessing a third-country legal and supervisory framework, ESMA assesses whether the requirements set out in Article 6, Article 7(2)-(5) and Sections A, B, and C of Annex I of the CRA Regulation are in place in addition to those aspects of conflicts of interest covered in the corporate governance section above.
62. These requirements involve the need for CRAs to:
- (a) identify and eliminate or alternatively manage and disclose conflicts of interest including those relating to shareholders of the CRA;
 - (b) be organised in a manner that ensures that its business interests do not impair the independence and accuracy of its credit rating activities;
 - (c) establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate, or manage and disclose any conflicts of interest;

- (d) identify, eliminate, or manage and disclose clearly and prominently any actual or potential conflicts of interest that may influence the analyses and judgment of its ratings analysts, employees, and other natural persons whose services are placed at the disposal or under the control of the CRA and who are directly involved in the issuance of credit ratings and persons approving credit ratings;
- (e) publicly disclose the names of the rated entities or related third parties from which it receives more than 5% of its annual revenue;
- (f) not issue a credit rating or in the case of an existing credit rating, immediately disclose that the credit rating is potentially affected in the circumstances set out in Annex 1 Section B paragraph 3 of the CRA Regulation for example situations where a shareholder holding 10 % or more of either the capital or the voting rights of that CRA or being otherwise in a position to exercise significant influence on the business activities of the CRA is also a significant shareholder or a board member of the rated entity;
- (g) ensure that the provision of ancillary services do not present conflicts of interest with its credit rating activity, and disclose in final rating reports any ancillary services provided for the rated entity or any related third party;
- (h) design its reporting and communication channels so as to ensure independence of related persons from the other activities of the CRA carried out on a commercial basis;
- (i) ensure that compensation and performance evaluation of the rating analysts and persons approving the credit ratings are not linked to the amount of revenue they generate;
- (j) disclose any actual and potential conflicts of interest;
- (k) have requirements whereby those who know of illegal conduct by others report it to the compliance officer without negative consequences;
- (l) require that where a rating analyst terminates his or her employment and joins a rated entity, in the credit rating of which the analyst has been involved, or a financial firm, with which the rating analyst has had dealings as part of his or her duties at the CRA, the CRA is required to review the relevant work of the analyst preceding his departure;
- (m) establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings; and
- (n) establish, maintain, enforce and document an effective internal control structure governing the implementation of policies and procedures to prevent and mitigate possible conflicts of interest and to ensure the independence of credit ratings, rating analysts and rating teams regarding shareholders, administrative and management bodies and sales and marketing activities.

63. In addition to the above:

- (a) a CRA as well as individuals and entities, who are in a position to exercise significant influence on the business activities of a CRA are prohibited from providing consultancy or advisory services to a rated entity or a related third party;
 - (b) credit rating analysts or persons approving ratings are prohibited from making proposals or recommendations on the design of structured finance products about which the CRA is expected to issue a rating; and
 - (c) credit rating analysts are prohibited from being involved in the negotiation of fees or payments with any rated entity, related third party or any person directly or indirectly linked to the rated entity by control.
64. In addition those persons referred to in paragraph (1) of Section C of Annex 1 of the CRA Regulation are prohibited from:
 - (a) engaging in transactions in financial instruments issued, guaranteed or otherwise supported by the rated entity;
 - (b) participating in or otherwise influencing the determination of a credit rating if those persons own financial instruments of the rated entity or any entity related to a rated entity or have had a recent employment or other business relationship with the rated entity that may cause a conflict of interest;
 - (c) soliciting or accepting monies, gifts or favours from anyone with whom the CRA does business;
 - (d) taking key management positions with the rated entity or its related third party within 6 months after the rating.
65. Overall, as can be seen from the above requirements, the EU approach to conflicts of interest management is a combination of requirements relating to how:
 - to ensure the CRA is organised so that conflicts of interest are managed,
 - to disclose certain interests which are considered to be a potential conflict,
 - to prohibit the CRA itself and those who are involved in the credit rating process from conducting certain activities,
 - to ensure that those who are key to determining the credit rating of credit rated entities and their instruments do not establish working relationships that may result in conflict, and
 - to ensure that the compensation of those involved in credit rating activities ensures the independence of their judgment.
66. This is another area where ESMA recognises that the approach to this may differ in a third country for example by setting out in the law a list of prohibited activities that are considered *de facto* to be conflicts of interest and are prohibited irrespective of the procedures and processes that a CRA may have in place.

67. ESMA recognises that the third-country laws and regulations in this area may not be as detailed or specific as those set out in the CRA Regulation.
68. However, ESMA points out that conflicts of interest management is fundamental to the ability of the CRA Regulation to achieve its objectives and does expect, that there are robust provisions embedded into the law that cover actual or potential conflicts of interest management and disclosure.
69. As such, ESMA considers that, in addition to those aspects of corporate governance set out in paragraphs 54 to 57 above, overall, the objectives of each individual conflict of interest management requirement described in paragraphs 62 to 64 above should be met through provisions embedded in the third country legal and regulatory framework, together with proper and effective supervision and enforcement.
70. However, ESMA can accept the following differences:
 - (a) disclosure regarding the names of clients from whom the CRA receives more than 5% of its annual revenue can be made only to the regulator so that it can monitor and supervise how the CRA is managing the conflicts that may arise in respect of these clients;
 - (b) requirements that relate to the need to review the work of the rating analyst prior to its departure to a rated entity do not need to be in place because this duplicates other requirements that would pick this issue up;
 - (c) requirements prohibiting certain individuals from taking key management positions with the rated entity or its related third party within 6 months after the rating – do not need to be in place because the conflict that is being addressed would be captured by other requirements;
 - (d) requirements relating to rotation of certain individuals;
 - (e) the requirement mentioned in point (f) of paragraph 62 above. ESMA accepts that thresholds in a third country may be different or that the third-country legislation does not explicitly address shareholders requirements. However, the third-country laws and regulations should provide sufficient protection against the risk that the interests of a significant shareholder impacts on the independence of the CRA, its analysts and/or its credit ratings/rating outlooks.
71. ESMA recognises that the requirements relating to the gradual rotation of rating analysts and persons approving credit ratings is one of a number of ways in which a CRA can achieve the objectives of the management of conflicts of interest requirements as set out in paragraph 59 above and the independence of rating analysts and persons approving ratings.
72. ESMA also recognises that these requirements are controversial in the sense that some market players consider such requirements as having the effect of potentially damaging the quality of ratings by diluting expertise, as well as being in contradiction to those requirements relating to knowledge and experience.

73. Others, on the other hand, welcome it as they consider it a good discipline to have to ensure that knowledge and expertise is shared as well as the ensuring that the nature of the working relationship between the credit rating analysts and the rated entity remains impartial.
74. ESMA does not consider it necessary that rotation requirements are in place in order to achieve the objective, but where there are no such requirements ESMA expects for example the legal requirements relating to conflicts of interest management to be very robust.

4.4 Organisational requirements

75. ESMA considers that the overall objective of the organisational requirements is to contribute to ensuring the objectivity, independence, integrity, and quality of the credit rating activities.
76. The CRA Regulation sets out a number of organisational requirements that CRAs need to have in place in order to be able to demonstrate its ability to meet these objectives and compliance with them.
77. These requirements can be divided as follows:
 - I) General organisational requirements;
 - II) Outsourcing;
 - III) Confidentiality; and
 - IV) Record keeping.

4.4.1 General organisational requirements

78. Article 6(2) and paragraphs (3)-(6), (8), (10) of Section A of Annex I of the CRA Regulation requires the CRA to:
 - (a) establish adequate policies and procedures that ensure compliance of its obligations under the relevant regulation;
 - (b) have sound administrative and accounting procedures, internal control mechanisms designed to secure compliance with decisions and procedures at all levels, effective procedures for risk assessment, effective control and safeguard arrangements for information processing systems;
 - (c) implement and maintain decision making procedures and organisational structures that clearly and in a documented manner specify reporting lines and allocates functions and responsibilities;
 - (d) establish and maintain a permanent and effective compliance function which operates independently;

- (e) employ appropriate systems, resources and procedures to ensure continuity and regularity in the performance of its credit rating activities;
 - (f) monitor and evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with the authorities' requirements and take appropriate measures to address any deficiencies.
79. In respect of the above requirements, ESMA considers that these are necessary to facilitate the CRA's ability to achieve the objectives set out in paragraph 75 above, although it does not expect the identical requirements to be hard wired into a third-country regulatory framework.
80. ESMA needs to take an in-depth look at what organisational requirements are in place as a package, and in addition consider the nature and extent of the supervisory and enforcement powers and practices that are in place, as discussed in Section G below.
81. Having assessed what is in place as a package, ESMA considers that the overall organisational requirements must objectively achieve the purposes discussed above in order to be assessed equivalent to the EU requirements or reached the initial condition for endorsement.
82. As such, for example ESMA can accept that there may not be an identical requirement set out in the law to have a permanent and effective compliance function which operates independently, but it does expect the objective of this requirement to be somehow in place.

4.4.2 Outsourcing

83. Article 9 of the CRA Regulation prohibits outsourcing of important operational functions in such a way so as to impair materially the quality of the CRA's internal control and the ability of the authorities to supervise the credit ratings agency's compliance under the CRA Regulation.
84. In assessing the equivalence of this prohibition, ESMA asked a number of questions to establish:
- (a) if any outsourcing of important operational functions is allowed;
 - (b) if any restrictions in respect of outsourcing exist;
 - (c) whether or not the regulatory framework ensures that:
 - i. none of the outsourced functions impair the quality of the CRA's internal controls; and
 - ii. that the outsourcing does not impair the ability of the relevant authority to supervise the CRA's compliance with its regulatory obligations.
85. In respect of these requirements, ESMA considers that, where outsourcing is allowed in the third country, for the purposes of a positive assessment of the equivalence, the third-country regulatory framework shall set out conditions for outsourcing aimed at ensuring that the following objectives are achieved:

- (a) none of the outsourced functions impair the quality of the CRA's internal controls, and
- (b) the ability of the authority to supervise the CRA's compliance with its legal obligations is not impaired.

86. In addition, ESMA expects that if outsourcing is allowed:

- (a) there needs to be legal clarity regarding what can be outsourced; and
- (b) the legal responsibility for what is being outsourced shall remain with the CRA.

4.4.3 Confidentiality

87. Requirements relating to confidentiality are important because of the nature of the information that the CRA and its employees have access to. There is a need to ensure that confidential information is only used for purposes related to credit rating activities and is protected from fraud, theft or misuse.

88. The CRA Regulation imposes a number of confidentiality obligations on rating analysts, employees of the CRA as well individuals whose services are placed at the disposal or under the control of the CRA and who are directly involved in credit rating activities as well as individuals closely associated with them as set out in Article 7(3) and Annex I Section C paragraph 3 of the CRA Regulation as follows:

- (a) to take all reasonable measures to protect property and records in possession of the CRA from fraud, theft or misuse;
- (b) to not disclose any information about credit ratings or future ones other than to the rated entity or its related third party;
- (c) to keep information entrusted to the CRA confidential;
- (d) to not use or share confidential information for trading purposes or any other purpose other than credit rating activities;

89. According to Article 10(2a) of the CRA Regulation, credit ratings, rating outlooks and information relating thereto, shall be treated as inside information, until the moment when they have been disclosed to the public.

90. ESMA considers these requirements to be very important for the reasons set out above, and it expects the objectives of these requirements to be met for the purposes of assessing equivalence.

4.4.4 Record Keeping

91. Effective record keeping enables a CRA to document the manner in which it meets its legal obligations, as well as allowing its regulator to supervise that this is being done.

92. Article 6(2) and paragraphs (7)-(9) of Section B of Annex I of the CRA Regulation require CRAs to keep adequate records and, where appropriate, audit trails of their credit rating

activities for at least five years and make them available upon request to the competent authority.

93. ESMA considers this requirement to be crucial but can accept that the period of time for which records need to be kept may differ from jurisdiction to jurisdiction, but whatever is in place has to be reasonable.

4.5 Quality of Methodologies and Quality of Ratings

94. In addition to the general organisational requirements referred to above, the CRA Regulation sets out a number of requirements aimed at ensuring the following objectives:

- (a) that the methodologies, models and key rating assumptions that are used in credit rating activities are rigorous, continuous and thorough;
- (b) the adequate quality, integrity and thoroughness of the credit rating activities;
- (c) the protection of the stability of financial markets and of investors as set out in recital 7 of the CRA Regulation; and
- (d) that ratings and methodologies are subject to validation as well as the adequate quality and thoroughness of ratings.

95. These requirements are set out in Article 6(2) – paragraph (9) of Section A of Annex I, Article 7(1), Articles 8(2), 8(3), 8(4), 8(5), 8(6), Article 10(2) and part I of Section D of Annex I of the CRA Regulation, and can be divided into the following areas:

- I) Reviewing credit ratings, methodologies, models and assumptions and information used in issuing ratings;
- II) Knowledge and experience of employees directly involved in credit rating activities;
- III) Quality of credit ratings and analysis of information used in assigning credit ratings;
- IV) Quality of methodologies and changes to them; and
- V) Competition.

4.5.1 Reviewing credit ratings, methodologies, models and assumptions and information used in issuing ratings

96. The CRA Regulation sets out a number of requirements dealing with the review of credit ratings, methodologies, models and assumptions as well as the need to review the information used in issuing ratings in Article 8(2), Article 8(5), Article 8(6) and paragraph (9) of Section A of Annex I.

97. These requirements require a CRA to:

- (a) have a review function devoted to the periodical review of methodologies, models, key rating assumptions;
 - (b) monitor its ratings and methodologies on an on-going basis and at least annually; and
 - (c) review the affected credit ratings as soon as possible and not later than within 6 months after the change, and in the meantime place those ratings under observation.
98. ESMA considers it important that methodologies are up-to-date and subject to a comprehensive review on a periodic basis.
99. ESMA does not consider it necessary for there to be a separate review function per se, but that whatever requirements are in place, that these achieve a periodic review of methodologies, models, and key rating assumptions by those who are independent from those that are responsible for the development and use of these models, key rating assumptions, and models.
- #### 4.5.2 Knowledge and experience of employees directly involved in credit rating activities
100. The CRA Regulation sets out requirements relating to the nature of the knowledge and experience of CRA's employees directly involved in credit rating activities in Article 7(1).
101. This requirement is that the CRA ensures that rating analysts, employees of the CRA, and any other natural person directly involved in credit rating activities have appropriate knowledge and experience for the duties assigned.
102. ESMA considers it important that those involved in credit rating activities have the necessary skills and knowledge to carry out their respective responsibilities, and that this is an area that needs to be covered in the relevant third-country framework.
103. ESMA recognises that the EU requirement has embedded a test of appropriateness, which is subjective and is something that will need to be assessed on a case-by-case basis.
104. The question is therefore whether embedding the "appropriateness" requirement in law means that in practice those doing the job are appropriately qualified, and who is best placed to assess this.
105. ESMA considers that the lack of an appropriateness test in a requirement can still result in the objective of the provision being met, provided there is disclosure regarding those individuals doing the job, and the ability to take legal action where it is clear in practice that those doing it are not appropriate.

4.5.3 Quality of credit ratings and analysis of information used in assigning credit ratings

106. The CRA Regulation sets out a number of requirements dealing with the quality of ratings and the information that credit rating analysts have to use when assigning ratings, as well as ensuring that the information is up to date and accurate.
107. These requirements are set out in Articles 8(2), 8(5), 10(2), and part I of Section D of Annex of the CRA Regulation. These requirements are:
- (a) to adopt, implement and enforce adequate measures to ensure that the credit ratings they issue are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis according to their rating methodologies;
 - (b) to adopt all necessary measures so that the information they use in assigning a credit rating is of sufficient quality and from reliable sources;
 - (c) to establish internal arrangements to monitor the impact of changes in macroeconomic or financial market conditions on credit ratings;
 - (d) to inform the entity subject to the rating during working hours of the rated entity and at least a full working day before publication of the credit rating including the principal grounds on which the rating is based in order to give the entity an opportunity to draw attention of the CRA to any factual errors;
 - (e) to refrain from issuing a credit rating or withdraw an existing rating if they do not have sufficient quality information to base their ratings on; and
 - (f) to establish an appropriate gradual rotation mechanism with regard to rating analysts and persons approving credit ratings.
108. ESMA considers these requirements are important for the purposes of achieving the objective of ensuring that the ratings being issued are robust, well founded and based on reliable information and overall are of adequate quality.
109. ESMA does not expect to see identical requirements in the third-country legal and supervisory framework however, it expects to see requirements that are able to achieve this objective.
110. In respect of the requirement set out in paragraph 107 c) above, ESMA does not consider that this needs to be addressed by a separate requirement as is the case in the CRA Regulation because it expects this to be covered in the obligation to ensure that ratings are based on accurate and up to date information.
111. In respect of the requirement set out in paragraph 107 d) above, ESMA does not consider it necessary that there is a specific requirement that the CRA to inform the rated entity at least a full working day before the publication of a credit rating. Other timeframes may be acceptable as long as the CRA provides to the rated entity with the opportunity to draw attention to possible factual errors.

112. In respect of the requirement set out in paragraph 107 107(f) above, and as discussed in paragraphs 71 to 74 above, ESMA does not consider it necessary that there is a specific requirement that the CRA establishes a gradual rotation mechanism.

4.5.4 Quality of methodologies and changes to them

113. The CRA Regulation sets out a number of requirements relating to the quality of methodologies and what needs to be done when methodologies, models or key rating assumptions used in credit rating activities are changed, as set out in Article 8(3) and 8(6) (a)-(c) of the CRA Regulation.

114. These requirements impose an obligation on CRAs to:

- (a) use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing;
- (b) apply the changes in methodologies and models consistently to existing ratings; and
- (c) immediately disclose the likely scope of credit ratings to be affected by using the same means of communication as was used for the distributions of the affected credit ratings.
- (d) publish any proposed material changes or proposed new rating methodologies on its website inviting stakeholders to submit comments for a period of one month together with a detailed explanation of the reasons for and the implications of the proposed material changes or proposed new rating methodologies;
- (e) immediately inform the competent supervisor and publish on its website the results of the consultation and the new rating methodologies together with a detailed explanation thereof and their date of application;
- (f) immediately publish on its website the responses to the consultation relating to changes in rating methodologies except in cases where confidentiality is requested by the respondent to the consultation;
- (g) notify the supervisor of identified errors in methodologies and all affected rated entities explaining the impact on its ratings including the need to review issued ratings; where errors have an impact on its credit ratings, publish those errors on its website; and correct those errors in the rating methodologies.

115. ESMA considers that these requirements are significant in ensuring that the CRA is able to achieve the overall objective of these requirements. However, ESMA does not expect identical requirements to be hard-wired into a third-country regulatory framework. In particular, ESMA may accept that points (d)-(g) are not in place if the third-country supervisory and legal framework ensures an adequate level of quality, rigour and transparency of rating methodologies through other means.

4.5.5 Competition

116. The CRA Regulation has a number of requirements relating to the rating of structured finance products where the CRA has not rated the underlying assets of the product.
117. These requirements are set out in Article 8(4) of the CRA Regulation. Article 8(4) imposes a prohibition on the CRA to refuse to issue a credit rating of an entity or a financial instrument because a portion of the entity or the financial instrument had been previously rated by another CRA, where a CRA is using an existing credit rating prepared by another CRA with respect to underlying assets or structured finance instruments;
118. According to Article 8(4) a CRA shall, furthermore, record all instances where in its credit rating process it departs from existing credit ratings prepared by another CRA with respect to underlying assets or structured finance instruments providing a justification for the differing assessment.
119. ESMA does not consider that these requirements need to be in place.
120. According to paragraph 3c of Section B of Annex I of the CRA Regulation, a CRA should ensure that fees charged to its clients for the provision of credit rating 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 CRA or on any other result or outcome of the work performed. If this requirement is not in place, ESMA considers that there should be other safeguards to ensure that the objectives of avoiding conflicts of interests and promoting fair competition are achieved.

4.6 Disclosure

121. The information that has to be disclosed either to the public or the supervisor in respect of credit ratings and the CRA and its activities forms another set of core prescriptive requirements.
122. For the purposes of equivalence and endorsement, ESMA has subdivided the CRA Regulation's disclosure requirements as follows:
- I) Presentation and disclosure of credit ratings;
 - II) General and periodic disclosure about the CRA.

4.6.1 Presentation and disclosure of credit ratings

123. In light of the number of presentation and disclosure of ratings requirements, for the purposes of this advice, ESMA has further categorized these requirements into:
- (a) General provisions on the presentation and disclosure of any credit ratings; and
 - (b) Additional requirements in respect of the presentation and disclosure of credit ratings for structured finance products.

General provisions on the presentation and disclosure of any credit ratings

124. The CRA Regulation sets out a number of detailed requirements relating to the disclosure and presentation of ratings. ESMA considers that the objectives of these requirements aim at ensuring that ratings are disclosed in a timely manner and in a non-selective basis, and that adequate information is provided to the users of credit ratings in order to allow them to conduct their own due diligence when assessing whether or not to rely on those credit ratings.
125. Namely, pursuant to Article 10(1), (4), (5), (6) Article 11(2), and paragraph (5) of Section D of Annex I of the CRA Regulation, CRAs are required to:
- (a) disclose any credit rating, as well as any decisions to discontinue a credit rating, on a non-selective basis and in a timely manner;
 - (b) refrain from using the name of the competent authority in such a way that would indicate endorsement or approval by that authority of the credit rating or any credit rating activities of the CRA;
 - (c) disclose its policies and procedures regarding unsolicited credit ratings and ensure that unsolicited credit ratings are identified as such;
 - (d) in the case of an unsolicited credit rating, information on whether or not the rated entity or related third party participated in the credit rating process and whether the CRA had access to the accounts and other relevant internal documents of the rated entity or its related third party – whilst required by the CRA Regulation, it is not necessary that it is a legal requirement in the third country that the latter is indicated using a clearly, distinguishable different colour code for the rating category;
 - (e) when announcing a credit rating, to explain in their press releases or reports the key elements underlying the credit rating;
 - (f) make available information on its historical performance data, including the rating transition frequency and information about credit ratings issued in the past and their changes; and
 - (g) in presenting credit ratings or rating outlooks, avoid presenting factors other than those related to the credit ratings.
126. In addition, according to Article 8(2), 8(2a), 10(2)-(2a) and paragraphs (1), (2), (4) of Section D of Annex I of the CRA Regulation, CRAs should ensure that the following information is indicated in the credit ratings or rating outlooks:
- (a) the name and job title of the lead rating analysts as well as the name and the position of the person primarily responsible for approving the rating;
 - (b) all substantially material sources used to prepare the credit rating, with an indication of whether the credit rating has been disclosed to that rated entity or its related third party and amended following that disclosure;
 - (c) the principal methodology or methodology version that was used in determining the rating, with a reference to its comprehensive description;

- (d) the meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitive analysis of the relevant key rating assumptions, accompanied by an explanation of the worst-case and best-case scenario credit ratings;
- (e) the date of first release of the credit rating for publication as well as of its last update;
- (f) information on whether the credit rating concerns a new financial instrument and whether the CRA is rating it for the first time;
- (g) any attributes and limitations of a credit rating, and in particular to what extent the CRA has examined the quality of information used in the rating process and whether it is satisfied with the quality of information it bases its rating on;
- (h) a reference to the historical default rates together with an explanatory statement of the meaning of those default rates;
- (i) a statement that an issued credit rating or rating outlook is the agency's opinion and should be relied upon to a limited degree; and
- (j) if the credit rating constitutes a change of an existing credit rating it should be issued in accordance with the CRA's published rating methodologies.

127. ESMA considers that, for the purposes of equivalence and endorsement, overall, the objectives of each individual requirement described in paragraphs 125 to 126 above should be met through provisions embedded in the third country legal and regulatory framework, together with proper and effective supervision and enforcement. However, ESMA can accept the following differences for the purposes of endorsement or equivalence:

- (a) decisions to discontinue a credit rating are to be disclosed, but there is no requirement to indicate the reasons for such a decision;
- (b) the requirement, when announcing a credit rating, for press releases or reports to indicate the key elements underlying the credit rating, provided that it is ensured that such key elements are provided to investors when ratings are announced;
- (c) the name and job title of the lead rating analysts as well as the name and the position of the person primarily responsible for approving the rating are not to be disclosed in the credit rating, provided that record of this information is kept;
- (d) credit ratings are not required to indicate whether the credit rating concerns a new financial instrument and whether the CRA is rating it for the first time, since it expects this requirement to be covered through the requirement to indicate the attributes and limitations of the credit ratings that are disclosed;
- (e) points (h) and (i) of paragraph 126 may be achieved by means other than an explicit legal requirement; and
- (f) point (g) of paragraph 125 may be achieved by other means, for example through a general requirement that the presentation of the credit rating may not be misleading.

128. Finally, the entry into force of CRA 3 has expanded the scope of two disclosure requirements in Section D of Annex I, which were previously limited to structured financed instruments:

- (a) Paragraph 2a, a CRA should accompany the disclosure of methodologies, models and key rating assumptions with guidance explaining the assumptions, parameters, limits and uncertainties surrounding the models and methodologies used in such credit ratings as well as any expected change of the credit rating;
- (b) paragraph 6, a CRA shall disclose on its website, and notify ESMA on an ongoing basis, information about all entities or debt instruments submitted to it for their initial review or for preliminary rating. Such disclosure shall be made whether or not issuers contract with the CRA for a final rating

129. An important objective of the requirement in paragraph 128(b) above is to limit the risk of rating shopping. This objective may be achieved through other means.

Additional requirements in respect of the presentation and disclosure of credit ratings for structured finance instruments

130. The CRA Regulation imposes additional requirements in respect of the presentation and disclosure of ratings related to structured financial instruments.

131. The aim of these requirements is to ensure that ratings for structured financial instruments are clearly identifiable as such, and that investors receive appropriate information to deal with the additional complexity of these products.

132. Namely, Article 10(3) CRA Regulation requires CRAs that rate structured finance instruments to ensure that credit categories attributed to those structured finance instruments are clearly differentiated by the use of a specific symbol.

133. In addition, CRAs that rate structured financial instruments are required to provide in the relevant credit ratings the additional information set out in paragraphs (1), (2) of Part II of Section D of Annex I of the CRA Regulation, as detailed below:

- (a) all information about loss and cash-flows analysis performed or relied upon by the CRA as well as about expected changes in the credit rating;
- (b) information on whether the CRA has performed any assessment concerning the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments (specifying what level of assessment) or whether the CRA has relied on a third party assessment.

134. Taking into account the complexity of structured finance products, ESMA considers it important that additional requirements are in place for the presentation and disclosure of credit ratings related to these types of products.

135. Out of the requirements set out in paragraphs 132-133 above, ESMA considers that it shall be, as a minimum, ensured that information is disclosed about the level of

assessment, if any, conducted by the CRA on the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance instruments.

4.6.2 General and periodic disclosure about the CRA

136. In addition to the requirements on disclosure and presentation of credit ratings, the CRA Regulation imposes a number of prescriptive disclosure requirements on CRAs in relation to their organisation and their activities, including the methodologies they use for determining and publishing credit ratings.
137. ESMA considers that the objectives of the general and periodic disclosure requirements of the CRA Regulation are aimed at ensuring transparency about credit rating activities, at making information available to the public to allow it to perform an assessment on whether to rely on certain credit ratings as well as at providing information to competent authorities for the purposes of on-going supervision.
138. For the purpose of this Methodological Framework, a distinction is made between:
- (a) General additional disclosure requirements; and
 - (b) Periodic additional disclosure requirements, which include the information expected to be provided in the transparency reports.

General additional disclosure requirements

139. According to Article 11(1) and Part I of Section E of Annex I of the CRA Regulation, a CRA is required to generally disclose to the public the following information:
- (a) the fact that it is registered;
 - (b) a list of ancillary services;
 - (c) the policy of the CRA concerning the publication of credit ratings and other related communications;
 - (d) the general nature of its compensation arrangements;
 - (e) the methodologies, and descriptions of models and key rating assumptions as well as their material changes;
 - (f) any material modification to its systems, resources or procedures; and
 - (g) where relevant, its code of conduct.
140. ESMA recognises the importance of the disclosure of such information for the purposes of achieving the objectives referred to in paragraph 137 above. ESMA considers that it is necessary to assess, whether or not as a minimum, the information referred to under letters a), b), c), e), g) of paragraph 139 above is disclosed to the public. ESMA can accept that the information referred to under letters d) and f) of paragraph 139 above is provided only to the competent authority.

Periodic Additional disclosure requirements

141. Article 11(3) and paragraph (2) of Part II of Section E of Annex I of the CRA Regulation require CRAs to provide, on an annual basis, to the competent authority:
- (a) list of fees charged to each client for individual credit ratings and any ancillary services; and
 - (b) a list of the clients whose contribution to the growth rate in the generation of the CRA's revenue in the previous financial year exceeded the growth rate in the total revenue of the CRA in that year by a factor of 1.5 times
 - (c) the pricing policy, including the fees structure and pricing criteria in relation to credit ratings for different asset classes.
142. ESMA expects the third-country legal and supervisory framework to impose some form of disclosure requirement regarding revenue generation by the CRA and that the third-country supervisor has the power to request all the information listed above.
143. In addition to these requirements, Article 11(2) and paragraph (1) of Part II of Section E Annex I of the CRA Regulation requires CRAs to make available to the public, on a half-yearly basis, data about the historical default rates of their rating categories, distinguishing between geographical areas of the issuers and whether these default rates have changed over time.
144. ESMA considers that the third country legal and regulatory framework shall require CRAs to disclose to the public data about historical default rates of rating categories and their changes over time. However, ESMA can accept that the frequency for publication may be different, as well as that no distinction is made between the geographical areas of the issuer.
145. In addition, under Article 12 and Part III of Section E of Annex I of the CRA Regulation, CRAs are required to make the following information available to the public on an annual basis in an annual report on their internet website:
- (a) a detailed description of their legal structure, ownership and revenue streams;
 - (b) a description of the internal control mechanisms ensuring quality of their credit rating activities;
 - (c) a description of their record keeping policy;
 - (d) a description of their management and rotation policy;
 - (e) statistics on the allocation of their staff to new credit ratings, credit rating reviews, methodologies or model appraisals and senior management, and on the allocation of staff to rating activities with regard to the different asset classes (corporate — structured finance — sovereign);
 - (f) the outcome of the annual internal review of their independent compliance function; and

(g) financial information on the revenue of the credit rating agency, including total turnover, divided into fees from credit rating and ancillary services with a comprehensive description of each, including the revenues generated from ancillary services provided to clients of credit rating services and the allocation of fees to credit ratings of different asset classes. Information on total turnover shall also include a geographical allocation of that turnover to revenues generated in the Union and revenues worldwide.

146. Whilst according to the CRA Regulation these requirements need to be disclosed to the public, ESMA considers disclosure to the authority is adequate. In addition, ESMA considers that it can accept that CRAs are not required to disclose the statistics referred to under letter e) in paragraph 145 above. The level of detail concerning the disclosures mentioned in letter g) do not need to be identical to the EU requirements.

4.7 Effective supervision and enforcement

147. Article 4(3)(f) and 5(6)(a) of the CRA Regulation include as preconditions for endorsement or certification that:

- (a) CRAs in the third country are subject to effective supervision and enforcement on an ongoing basis (Article 5(6)(a)); and
- (b) the CRA established in the third country is authorised or registered, and is subject to supervision in that third country (Article 4(3)(f)).

148. The following provides a fixed set of criteria for assessing a third-country supervisory regime. When assessing a third-country framework for the purposes of endorsement, ESMA may, however pursuant to the slight difference in wording between Article 4(3)(f) and 5(6)(a), accept a lower level of effectiveness and enforcement powers.

149. In addition, the coordination arrangements that need to be in place in accordance with Articles 4(3)(h) and 5(7) have to include provisions relating to the “coordination of supervisory activities...”.

150. In assessing the nature of a third-country supervisory framework, ESMA divided the requirements into the following areas:

- I) the methods that the authority has in place to ensure that it is adequately staffed;
- II) the powers of the relevant authority; and
- III) the nature of the penalties that can be imposed.

151. ESMA points out that it does not make any judgments regarding the approach that the third country regulator adopts in relation to on-going supervision, for example, whether a risk-based approach is a good or bad thing, but is overall looking to get comfort that the supervision that will or is being done can be or is in practice effective.

4.7.1 The methods that the third-country authority has in place to ensure that it is adequately staffed

152. The nature of supervision and enforcement that takes place in respect of monitoring and supervising the CRAs' adherence to their obligations and taking action where they do not, is heavily dependent upon the number of staff that the relevant authority charged with the legal responsibility of supervising these entities has in place.
153. Article 22(2) of the CRA Regulation requires that competent authorities in the EU be adequately staffed, with regard to capacity and expertise, in order to be able to apply the CRA Regulation.
154. ESMA does not expect to find a similar legal provision but ESMA does expect that there will be an adequate number of staff.
155. In the EU there is no standardisation of what "adequate" means and the minimum number of staff or their expertise for the purposes of applying the CRA Regulation, as such there is no benchmark against which ESMA can assess a third-country supervisor for the purposes of equivalence and endorsement.
156. However, without the necessary staff there cannot be "effective supervision", as such, ESMA has sought to understand how the regulator in question either already does, or will, in the future be organising itself, and how many staff it has or will have.
157. ESMA is conscious of the fact that this is an area that may change in respect of the third country that it is assessing, but clearly if there is no thought to how supervision will in practice be carried out – then irrespective of the powers that the supervisors may have at its disposal to use, ESMA cannot say that the supervision is or will be effective.

4.7.2 The powers of the relevant authority

158. Articles 23b-23d of the CRA Regulation sets out the details of the powers ESMA has order to be able to discharge its legal duties under CRA Regulation.
159. The necessary powers that the authority need to have are the power to:
- (a) access to any document in any form and to receive or take a copy thereof;
 - (b) demand information from any person and if necessary to summon and question a person with a view to obtaining information;
 - (c) carry out on-site inspections with or without announcement;
 - (d) require records of telephone and data traffic.
160. In addition, as set out in Article 24 of the CRA Regulation, the authority in question has to be able to take the following measures against a CRA following the establishment of a breach by it in respect of its obligations under the CRA Regulation:

- (a) to withdraw the CRA's registration or authorisation;
- (b) to prohibit the CRA from temporarily issuing credit ratings;
- (c) to suspend the use of credit ratings issued by the CRA for regulatory purposes;
- (d) to take appropriate measures to ensure that the CRA continues to comply with its legal requirements;
- (e) to issue public notices where the CRA is in breach of its obligations arising from the relevant regulatory framework in your jurisdiction; and
- (f) to refer matters for criminal prosecution to the relevant national authorities.

161. ESMA considers that all the above powers need to be firmly embedded in the relevant law in order to be able to classify the third country regime as having effective supervision which it considers to be equivalent to that of the EU's.

162. In addition, as set out in the final paragraph of Article 23b(1) of the CRA Regulation the authority needs to be able to exercise these powers in respect of:

“CRAs, persons involved in credit rating activities, rated entities and related third parties, third parties to whom the CRAs have outsourced certain functions or activities; and person otherwise related or connected to CRAs or credit rating activities.”

163. As such ESMA needs to assess not only the nature of the powers that can be exercised, but also against whom these powers can be exercised in assessing whether or not the supervision is or can be “effective.”

4.7.3 Sanctions

164. Article 36 of the CRA Regulation sets out that the penalties that can be imposed need to be: “effective, proportionate and dissuasive” – but leaves it to each authority to determine what these should be.

165. ESMA expects that the relevant third-country framework has legal provisions setting out what the penalties that can be imposed for breaches of the relevant requirements are, but does not expect these penalties to be published.