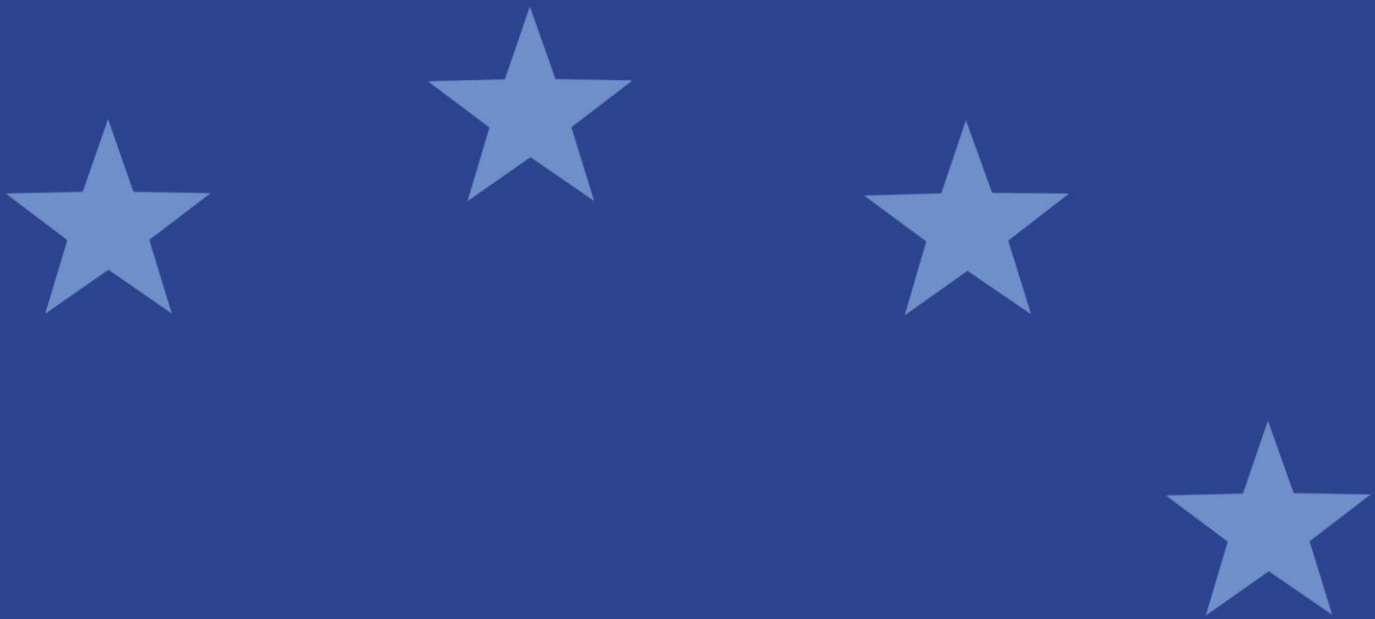




European Securities and  
Markets Authority

# Final Report

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



# 1 Table of Contents

1	Executive Summary .....	4
2	Feedback Statement .....	5
3	Cost-Benefit Analysis .....	23
	Annex I: Guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation .....	28
1	Scope .....	28
2	Purpose .....	30
3	Compliance and reporting obligations .....	30
4	Guidelines .....	30
	Annex II: Methodological framework for assessing a third country supervisory and legal framework for the purpose of endorsement .....	34
1	Background: The process of approving endorsement from a third country .....	34
2	Methodological framework for assessing a third-country supervisory and legal framework for the purposes of endorsement .....	37
	Annex III: Requirements in CRAR which are met by one or more third-country CRAs in a way which is different from how an endorsing CRA of the same group meets them .....	51

## Definitions, legislative references and acronyms

CESR	Committee of European Securities Regulators
ESMA	European Securities and Markets Authority
The Commission	The European Commission
CP	Consultation paper: Update of the guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation (ESMA33-9-159) published on 4 April 2017
The CP Guidelines	The draft revised Guidelines on Endorsement as presented in Annex II of the CP
The final Guidelines	The final updated guidelines on endorsement as presented in Annex I of this document
CRAR	The 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 the ERP	Commission delegated Regulation (EU) No 2015/2 of 30 September 2014 with regard to regulatory technical standards for the presentation of the information that CRAs make available to ESMA
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 2011 Guidelines	Guidelines on the application of the endorsement regime under Article 4(3) of the CRA Regulation (ESMA/2011/139) adopted in May 2011

The 2017 Technical Advice to the Commission on CRA Equivalence	Final Report: Technical advice on CRA regulatory equivalence – CRA 3 update (ESMA33-9-207) published on 15 November 2017
The MF for equivalence	The Methodological Framework for assessing a third-country legal and supervisory framework for the purpose of equivalence as provided in Annex III of the 2017 Technical Advice to the Commission on CRA Equivalence
The MF for endorsement	The Methodological Framework for assessing the conditions relating to the third-country legal and supervisory framework for the purpose of endorsement. This document is provided in Annex II of this report.
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

# 1 Executive Summary

## Reasons for publication

Endorsement is one of two regimes provided in the CRA Regulation (CRAR) 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 CRAR requires ESMA to issue and update guidelines on the application of the endorsement regime specified under Article 4(3) of the same Regulation. This report contains an update of the Guidelines on the application of the endorsement regime under Article 4(3) of CRAR<sup>1</sup>, adopted in May 2011 (the 2011 Guidelines) including, inter alia, the new requirements introduced with CRA 3 which will enter into force for the purposes of endorsement 1 June 2018. The updated Guidelines aim to provide additional clarity on the obligations of EU CRAs and third-country CRAs which engage in endorsement, the notion of ‘objective reasons’ and ESMA’s supervisory powers with regard to endorsed credit ratings.

In this Final Report, ESMA considers the responses received to the Consultation Paper (CP) during Q2 of 2017. The Guidelines also reflect discussions with stakeholders at an Open Hearing held on this topic on 17 May 2017.

## Contents

- Section 2 provides a summary of the feedback received from stakeholders to the CP as well as ESMA’s answers.
- Section 3 contains a cost-benefit analysis.
- Annex I contains the Final Guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation.
- Annex II contains ESMA’s methodological framework for assessing the conditions for endorsement relating to the legal and supervisory framework of a third-country.
- Annex III contains a list of requirements in CRAR which are currently met by one or more third-country CRAs in a way which is different from how an endorsing CRA of the same group meets them.

## Next Steps

The Guidelines in Annex I will be translated into the official EU languages and published on the ESMA website. The Guidelines will become effective 1 January 2019.

ESMA will aim to provide guidance on the requirements listed in Annex III in the first half of 2018 leaving CRAs with sufficient time to take them into account in advance of the 1 January 2019 deadline.

---

<sup>1</sup> Guidelines on the application of the endorsement regime under Article 4(3) of the CRA Regulation (ESMA/2011/139) adopted in May 2011, available at: [https://www.esma.europa.eu/sites/default/files/library/2015/11/esma\\_2011\\_139.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/esma_2011_139.pdf)

## 2 Feedback Statement

1. This section provides a summary of the responses to the *Consultation Paper on update of the Guidelines on the application of the endorsement regime under Article 4(3) of CRAR* (CP) and ESMA's answers as well as additional clarifications on ESMA's expectations, where appropriate.

### 2.1 General remarks

2. ESMA received in total nine responses, of which one was confidential. Responses were received from CRAs (6 responses), academics (2 responses), and a professionals (CRA) association.
3. Most of the respondents provided general remarks to the CP and some also provided dedicated answers to the specific questions in the CP. The general remarks focused on the change in approach represented by ESMA's modified understanding of the term 'requirements' in Article 4(3)(b) and specifically:
  - (a) ESMA's reasoning for changing its approach;
  - (b) the implications of this change in approach for third-country assessments for the purpose of equivalence and endorsement; and
  - (c) the potential unintended impacts of the change in approach.

#### *ESMA's reasoning for changing its approach*

4. Comments from several stakeholders questioned the rationale behind ESMA's decision to modify its understanding of the 'requirements' referred to in Article 4(3)(b) of CRAR and how they should be met. Under ESMA's 2011 Guidelines, compliance with the 'requirements' mentioned in Article 4(3)(b) was understood as compliance with the requirements established by law in the third-country where a CRA was based<sup>2</sup>. However, in the CP ESMA revised its approach and clarified that the 'requirements' should be understood as referring to a third-country CRA's internal requirements<sup>3</sup>.
5. Several CRAs pointed out that the European Commission supported the approach of the 2011 Guidelines and that the consequences of that approach were fully intended from the outset. Stakeholders also stated that, before embarking upon such significant changes, ESMA should clearly articulate the basis upon which it believes the existing regime is failing, that there is no publically available evidence to support such a fundamental change

---

<sup>2</sup> Paragraph 20 of the 2011 Guidelines states "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 [...]"

<sup>3</sup> Paragraph 13 of the CP Guidelines states "[...] 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 endorsement provisions of the CRA Regulation"

to the approach and that ESMA only provides a practical but not a legal explanation for the change.

6. **ESMA's response:** ESMA acknowledges that the final Guidelines present a change in approach compared to the 2011 Guidelines. The key argument underpinning the approach in the 2011 Guidelines relied on a cross-reading of Article 4(3)(b) on the one hand and 4(3)(f) and (h) on the other. Article 4(3)(f) requires that the third-country CRA is registered or authorised and subject to supervision and Article 4(3)(h) requires that ESMA has a cooperation agreement with the third-country supervisor. It was deemed that these requirements could not meaningfully be met without a legal and supervisory framework for supervising CRAs in that third country. ESMA continues to consider that the requirements in Article 4(3)(f) and (h) require the existence of a third-country legal and supervisory framework for CRAs which meet a certain standard compared to the EU framework.
7. However, it is ESMA's opinion that the requirement related to the conduct of a third-country CRA laid down in Article 4(3)(b) is *separate and in addition to* the requirements related to the local regulatory framework in the third country. Article 4(3)(b) envisages a mechanism whereby focus is strictly on the conduct of (the credit rating activities by) the third-country CRA (resulting in the issuing of the credit rating to be endorsed). Furthermore, Article 4(6) establishes a clear link between Article 4(3)(g) and 5(6)(a)-(c) by providing that an equivalence assessment by the European Commission relieves the endorsing CRA from the obligation of verifying that the condition laid down in article 4(3)(g) is met but does not relieve the endorsing CRA from the obligation laid down in Article 4(3)(b).
8. The key policy argument behind the approach adopted in the 2011 Guidelines was to avoid a return to self-regulation as applied prior to the adoption of CRAR. There was a concern that "*A regime based on the conduct of business rules of the foreign CRA on a voluntary basis could be understood as a self-regulating system*"<sup>4</sup>. However, rather than ensuring a robust and rigorous endorsement regime, this approach has resulted in significantly reducing the effectiveness of supervision over endorsed ratings.
9. With the new approach provided in the Final Guidelines, ESMA will continue to require that a third-country jurisdiction meets certain standards. ESMA will also continue to work closely with the local supervisor to ensure the quality of endorsed credit ratings. However, going forward ESMA will *separately and in addition to that* expect that the endorsing CRA fulfils its obligations as laid down in Article 4(3)(b) i.e. that it has verified and is able to demonstrate on an ongoing basis to ESMA that the conduct of the credit rating activities by the third-country CRA resulting in the issuing of the credit rating to be endorsed fulfils requirements which are at least as stringent as the relevant endorsement provisions of CRAR. In order to do so, ESMA can make use of the powers provided in CRAR to ask the endorsing CRA for information about the conduct of a third-country CRA and take supervisory actions against a CRA that endorses a credit rating which has not been

---

<sup>4</sup> Paragraph 102 on page 21 of CESR/10-347: "CESR's Guidance on Registration Process, Functioning of Colleges, Mediation Protocol, Information set out in Annex II, information set for the application for Certification and for the assessment of CRAs systemic importance" available at: [https://www.esma.europa.eu/sites/default/files/library/2015/11/1-10\\_347.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/1-10_347.pdf)

elaborated to standards which are as stringent as those established by CRAR. Ultimately, ESMA has the power to sanction an endorsing CRA which infringes Article 4(3).

*The implications of this change in approach for third-country assessments for the purpose of equivalence and endorsement*

10. Two CRAs asked why endorsed ratings and ratings issued by certified CRAs should be subject to different requirements and quoted the CESR guidance of 2010<sup>5</sup>, which addresses the question of endorsement. “*Therefore, CESR considers that there would be no objective reasons to set different requirements for the third country CRAs depending on the mechanism used. The requirements according to which the ratings are produced should achieve the same objectives irrespective of the route the foreign CRA has to follow. This would ensure a level playing field for all rating agencies.*”
11. **ESMA’s response:** If the ‘requirements’ in Article 4(3)(b) are understood to refer to the local rules and regulations, the provisions setting out the assessment criteria of a third-country legal and supervisory framework for equivalence (Articles 5(6)(a)-(c) and 5(7) of CRAR) and endorsement (Article 4(3)(b), (f), (g), and (h) of CRAR) are objectively very similar. It was hence logic that the two tests, in the past, were carried out using the same methodological framework.
12. However, under the new approach, as explained above, the ‘requirements’ in Article 4(3)(b) are understood as referring to the internal requirements of the third-country CRA and thus cannot simultaneously refer to the legal requirements of the third-country. In this light, it is clear that the equivalence and endorsement regimes set different standards to the third-country legal and supervisory regime. As illustrated in the table below, the equivalence requirements and the conditions for endorsement relating to the third-country legal and supervisory framework can be broken down into four components with varying levels of similarity:
  - a) Non-interference clause: the requirements for equivalence and endorsement are nearly identical.
  - b) The third country supervisory framework: the requirements are very similar except that the words “effective” and “enforcement” are added for the equivalence test.
  - c) The third-country legal framework: the approach under equivalence is very prescriptive referring to third-country legally binding rules equivalent to specific Articles in CRAR. In the case of endorsement, the existence of a legal framework can be inferred from the fact that the third-country CRA should be

---

<sup>5</sup> CESR/10-347, dated 4 June 2010 (CESR’s Guidance on Registration Process, Functioning of Colleges, Mediation Protocol, Information set out in Annex II, information set for the application for Certification and for the assessment of CRAs systemic importance



subject to “ongoing supervision” and that ESMA should have a cooperation agreement with said supervisor.

- d) The cooperation agreement with the third-country supervisor and ESMA: very similar approaches with a slightly stricter wording for endorsement.

	Endorsement	Equivalence
<b>Non-interference</b> Very similar	<u>Article 4(3)(g):</u> 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	<u>Article 5(6)(c):</u> the regulatory regime in that third country prevents interference by the supervisory authorities and other public authorities of that third country with the content of credit ratings and methodologies.
<b>The supervisory framework</b> Similar	<u>Article 4(3)(f):</u> the credit rating agency established in the third country is authorised or registered, and is subject to supervision, in that third country	<u>Article 5(6)(a):</u> credit rating agencies in that third country are subject to authorisation or registration and are subject to effective supervision and enforcement on an ongoing basis;
<b>The legal framework</b> Different	ESMA considers that for the conditions in Article 4(3)(f) and (h) to be met, there should be a legal framework for supervision of CRAs in the third-country with some resemblance to the EU framework.	<u>Article 5(6)(b):</u> credit rating agencies in that third country are subject to legally binding rules which are equivalent 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;
<b>Cooperation agreement</b> Similar	<u>Article 4(3)(h):</u> there is an appropriate cooperation arrangement between ESMA and the relevant supervisory authority of the credit rating agency established in a third country. ESMA shall ensure that such a cooperation arrangement shall specify at least: (i) the mechanism for the exchange of information between ESMA and the relevant supervisory authority of the credit rating agency established in a third country; and (ii) the procedures concerning the coordination of supervisory activities in order to enable ESMA to monitor credit rating activities resulting in the issuing of the endorsed credit rating on an ongoing basis	<u>Article 5(7):</u> ESMA shall establish cooperation agreements with the relevant supervisory authorities of third countries whose legal and supervisory frameworks have been considered equivalent to this Regulation in accordance with paragraph 6. Such arrangements shall specify at least: (a) the mechanism for the exchange of information between ESMA and the relevant supervisory authorities of the third countries concerned; and (b) the procedures concerning the coordination of supervisory activities.

13. While ESMA maintains that the assessment of a third-country legal framework is a precondition for endorsement, this condition is not based on Article 4(3)(b), but rather on Articles 4(3)(f) and (h). As explained above, Article 4(3)(f) and (h) require that the third country has a legal and supervisory framework for supervision of CRAs within the meaning of CRAR. On this basis, ESMA has concluded that the assessment of the conditions for endorsement relating to a third-country legal and supervisory framework should not be based on the same methodological framework used for assessing equivalence.

14. This is a different view from the one presented in the CP, where ESMA maintained the old approach, see for example paragraph 18 of the CP: “[...] 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 Framework<sup>6</sup>. 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

<sup>6</sup> Minor differences between the two tests are indicated in paragraphs 30(b), 31 and 147 and 148 of the Annex III.

*equivalence.*” ESMA took the view set out in paragraph 18 of the CP in the interest of simplicity and continuity. However, from consultation responses, ESMA has concluded that the confusion persisted and that the above mentioned approach provides additional clarity.

15. The methodological framework for assessing a third-country legal and supervisory framework for equivalence (the MF for equivalence) is provided in Annex III of the 2017 Technical Advice to the Commission on Equivalence. A separate methodological framework for assessing a third-country legal and supervisory framework for the purpose of endorsement (the MF for endorsement) is provided in Annex II of this report. The MF for endorsement focuses on the same seven areas as the MF for equivalence<sup>7</sup>, but for each area, ESMA has identified the minimum requirements which should be reflected in the legislation of the third-country in order to meet the conditions for endorsement laid down in Article 4(3)(f)-(h) of CRAR.
16. The distinction between the MFs for endorsement and equivalence should also be seen in the broader context of the two regimes which differ, inter alia, in terms of objective, scope and ESMA’s supervisory involvement.
17. The MF for equivalence is prescriptive and rigorous. This is important as ESMA has limited powers to monitor credit ratings entering the Union under this regime and, therefore, has to rely almost exclusively on the supervisory activities of the third-country supervisor.
18. The MF for endorsement consists of a subset of the criteria considered in the MF for equivalence. However, unlike the equivalence regime, the endorsement regime contains safeguards beyond the legal and supervisory framework of the third country to ensure the quality of the rating activities. First, in addition to complying with the rules and regulations of the third-country, the third-country CRA should adhere to its own policies and procedures which should be at least as stringent as the relevant endorsement provisions of CRAR<sup>8</sup>. Second, endorsement requires that an EU CRA assumes full responsibility for ensuring that an endorsed credit meets these additional requirements. Third, ESMA has the power to monitor and assess, through the endorsing CRA, the conduct by the third-country CRA resulting in the issuing of an endorsed credit rating. Fourth, ESMA can take supervisory measures against an endorsing CRA which fails to ensure that an endorsed credit rating meets the standards of CRAR.
19. ESMA has assessed all the jurisdictions previously accepted for equivalence against the new MF for Endorsement concluding that all the assessed jurisdictions meet the conditions for endorsement. Nevertheless, ESMA has advised the Commission that some of these jurisdictions are not *equivalent* to CRA 3 (see the 2017 Technical Advice on equivalence).

---

<sup>7</sup> Scope of the regulatory and supervisory framework, corporate governance, conflicts of interest management, organisational requirements including confidentiality and record keeping, quality of methodologies and quality of ratings, disclosure and supervision and enforcement.

<sup>8</sup> The requirements set out in Articles 6-12 and Annex I with the exception of Articles 6a, 6b, 8a, 8b, 8c, 8d and 11a, point (ba) of point 3 and points 3a and 3b of Section B as well as part III of Section D of Annex I of CRAR.

*The potential unintended impacts of the change in approach*

20. Several CRAs shared the concern that compliance cost may be high compared to the benefits achieved. That view was also shared by one academic who stated that the proposed new regime appears to be more onerous for CRAs, and may lead to some geographical re-alignments for the larger CRAs, and that costs may be in the end passed on to rating users. Another academic warned that if CRAs use more human capital to fulfil the regulatory requirements these costs might be then passed on the consumer (i.e. investors and issuers). In addition, it was mentioned that ESMA has not presented evidence regarding the quality and independence of ratings under the current endorsement regime.
21. **ESMA answer:** Previously, ESMA has not required CRAs to provide information on the internal requirements of the third-country CRAs. Without this information it is not possible to determine to which extent endorsed ratings, in practice, fulfil requirements which are as stringent as the EU requirement. For groups of CRAs which have implemented global policies and procedures and for whom divergences across CRAs in different jurisdictions are minor and of the same level of stringency, ESMA does not expect that these guidelines will have a material impact. For groups of CRAs, on the other hand, whose third-country entities follow very different and less stringent policies and procedures compared to the endorsing CRA, these guidelines will have an impact.
22. As part of the consultation process, ESMA has requested that CRAs submit additional information regarding the areas of difference in the policies and procedures they apply in the EU compared to those applied in the third-country CRAs which elaborate ratings that are being endorsed into the EU. Annex III to this report lists the requirements in Articles 6-12 and Annex I of CRAR which CRAs have indicated as being applied differently by third-country CRAs compared to the endorsing CRA. For these requirements, ESMA will provide guidance on what it considers to be “as stringent as” taking into account the principle of proportionality. This guidance will be added as an Annex of these Guidelines. Further analysis on the costs and benefits related to the proposed Guidelines is provided in Section 3 “Cost-Benefit Analysis” of this report.

## 2.2 Comments related to Article 4(3)(b)

**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.**

23. All CRA stakeholders and a professional association responded to this question. The responses focused on four main areas:
  - (a) ESMA’s understanding of what constitutes internal requirements that are at least as stringent as the requirements set out in CRAR;
  - (b) scope of the internal requirements to be at least as stringent as;

- (c) jurisdiction over endorsed credit ratings; and
- (d) the entry into force of these Guidelines.

*ESMA's understanding of what constitutes internal requirements that are at least as stringent as the requirements set out in CRAR*

24. All CRAs currently undertaking endorsement requested in their responses that ESMA provides further clarity concerning the requirements which third-country CRAs are required to fulfil pursuant to Article 4(3)(b) of CRAR. One CRA asked whether the methodological framework in Annex III to the CP could be relied upon for determining whether CRA's policies or procedures are as stringent as the requirement laid down Article 4(3)(b).
25. **ESMA's answer:** Annex III to the CP contained the MF for assessing equivalence pursuant to Article 5(6) of CRAR<sup>9</sup>. Annex II to this Final Report contains the new MF for assessing a third-country legal and supervisory framework for the purposes of endorsement pursuant to Article 4(3)(f)-(h) of CRAR. The purpose of these MFs is solely to provide clarity as to how ESMA performs the assessment of a third-country's legal and supervisory framework, and should not be relied upon for the purpose of assessing the conduct of a third-country CRA pursuant Article 4(3)(b) of CRAR. As stated above, the requirement in Article 4(3)(b) relates to the conduct and internal requirements of a third-country CRA and is separate and in addition to the requirements to the legal and supervisory framework of a third country. To meet the requirement in Article 4(3)(b), the endorsing CRA should verify that the third-country CRA, in addition to meeting the local regulatory requirements, fulfils the requirements set out in the relevant endorsement provisions of CRAR<sup>10</sup> or has implemented (different) internal requirements which are at least as stringent.
26. Several CRAs called for clear guidance regarding ESMA's understanding of what requirements are as stringent as the EU requirements, in order for CRAs to be able to comply therewith and assess the impact on their global policies and operations. One CRA warned that unilateral assessments by each endorsing CRA of the "as stringent as" test would result in a patchwork of inconsistent outcomes. Unless there is guidance and assurance that differences are tolerated and that identical matches are not required, endorsing and third-country CRAs will operate in an uncertain regulatory environment. Furthermore, all CRA respondents called for ESMA to adopt an approach which is objectives-based in order to limit the administrative cost to be imposed on third-country CRAs stating that this is supported by recital 13 of CRA 1 and recital 48 of CRA 3.
27. **ESMA's answer:** ESMA agrees that it is important to provide CRAs with the necessary legal certainty on these matters. ESMA also agrees that third-country CRAs are not required to adopt identical internal requirements when the same objective could be

---

<sup>9</sup> The final version of this methodological framework is published as Annex III of the 2017 Technical Advice to the Commission on CRA Equivalence.

<sup>10</sup> Articles 6a, 6b, 8a, 8b, 8c, 8d and 11a, point (ba) of point 3 and points 3a and 3b of Section B as well as part III of Section D of Annex I of CRAR.

achieved by other means. As indicated above, ESMA has, on the basis of input provided by CRAs, included in Annex III of this document a summary of the requirements set out in the relevant endorsement provisions of CRAR which are applied differently by third-country CRAs compared to the EU CRAs of the same group. ESMA will publish guidance on these requirements adding it as an Annex of these Guidelines. ESMA will provide this guidance in advance of the date of application of the final Guidelines, in order to provide CRAs with sufficient time to take them into account.

28. One CRA stated that the current lack of guidance on internal requirements which are as stringent as leaves open the question of whether an endorsing CRA should measure the third-country policy and procedure against:

- (a) the third-country regulation;
- (b) the CRA Regulation;
- (c) the endorsing CRA's parallel policy or procedure;
- (d) or some combination thereof?

29. **ESMA's answer:** The benchmark for assessing the internal requirements of a third-country CRA in accordance with Article 4(3)(b) is CRAR itself – not the third-country rules and regulations. Presuming that the endorsing CRA is already complying with the requirements of CRAR, having identical policies and procedures in a third-country CRA would provide a very high level of assurance of compliance.

*Scope of the internal requirements to be at least as stringent as*

30. One CRA pointed out that paragraph 6 of Annex III of the CP states that ESMA “has not changed the criteria for assessing any of the requirements pre-dating CRA 3”. Given that the pre-CRA 3 assessment was done on the basis of a full determination of the “as stringent as” requirement, rather than a minimum standards test, does that mean that CRAs need only assess compliance by the third-country CRAs with the relevant endorsement provisions of CRA 3, as well as any future changes to the EU CRA Regulation?

31. **ESMA's response:** In assessing the legal and supervisory framework of third-countries for the purpose of providing a technical advice to the Commission, ESMA has focused exclusively on the CRA 3 requirements (see The 2017 Technical Advice to the Commission on CRA Equivalence). This is because an assessment of the legal and supervisory framework of those jurisdictions against the pre-CRA 3 requirements has already been completed. The conclusion of these assessment was that all the assessed jurisdictions meet the conditions for endorsement while only some jurisdictions can be considered to have legally binding rules which are *equivalent* to the CRA 3 requirements. This is because the MF for endorsement (as provided in Annex II to this report) consists of a subset of the criteria applied in the MF for equivalence.

32. When an endorsing CRA assesses the policies and procedures of a third-country CRA, it should take into account the full body of relevant requirements as provided in Article 4(3)(b) of CRAR: Article 6 to 12 and Annex I, with the exception of Articles 6a 6b, 8a, 8b, 8c, 8d and 11a, point (ba) of point 3 and points 3a and 3b of Section B as well as part III of Section D of Annex I. As explained in paragraph 27 above ESMA will, for the requirements identified by the CRAs currently benefitting from the endorsement regime, provide guidance on what it considers to be at least as stringent as.
33. One CRA asked to clarify whether Article 8d and the parts of Annex I from CRAR relating to sovereign ratings are excluded from the scope of Article 4(3)(b). An association of CRAs argued that Article 8d should not be excluded from the scope of Article 4(3)(b) and Article 5(6)(a) of CRAR.
34. **ESMA's response:** ESMA understands, and clarifies in the final Guidelines, that Article 8d as well as the requirements in Annex I of CRAR relating to sovereign ratings are not to be considered when assessing the conduct of the third-country CRA. This approach is in line with the approach taken in paragraph 5 of Annex III to the CP:
- (a) Article 8d: Whilst Article 8d is not explicitly excluded from the scope of Articles 4(3)(b) and 5(6)(b), ESMA considers that Article 8d should not be taken into account when assessing the conduct of a third-country CRA as it does not establish any obligations on CRAs – only on issuers.
  - (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)(b). Although CRA 3 does not explicitly exclude part III of Section D of Annex I of CRAR, which relates to Article 8a, from the scope of these Articles, ESMA is of the view that part III of Section D of Annex I of CRAR builds on and cannot be read independently of Article 8a.

#### *Jurisdiction over endorsed ratings*

35. One CRA asserted that the CP Guidelines introduce the possibility of concurrent jurisdiction and conflicting enforcement. As an example, a third-country regulator may examine a third-country CRA and determine that its credit ratings are in compliance with the regulation of that third country. At the same time, ESMA could conclude that while these credit ratings, which were endorsed, may have been in compliance with the third-country regulation, they were not produced in accordance with requirements which are at least “as stringent as” those set out in CRAR. The third-country CRA is regulated by and accountable to the third-country regulatory supervisor, and its conduct must therefore conform to third-country rules and regulations. However, under the proposed updated guidelines, it is unclear as to whom the third-country CRA would ultimately be accountable. The CRA calls for ESMA to leverage the third-country regulatory expertise and supervisory oversight by relying on the third-country supervisor.

36. **ESMA's response:** A third-country CRA is registered with a local supervisor and cannot be subject to enforcement action by ESMA. If an EU CRA wishes to endorse credit ratings produced by another CRA belonging to the same group and established in a third country, the EU CRA assumes full responsibility vis-à-vis ESMA for those credit ratings. If the EU CRA has not verified or is not able to demonstrate compliance of the conduct by the third-country CRA with the requirements in the Article 4(3)(b) it risks enforcement action. In the event that a third-country CRA is subject to a supervisory action by its local supervisor, the endorsing CRA should consider the impact for endorsability and if necessary, take one or more of the steps listed in paragraph 17 of the final Guidelines. In this context, it is entirely possible that a credit rating elaborated in a third-country meets the local regulatory requirements of a third-country but not Article 4(3)(b).
37. One CRA cautioned that in practice, despite its powers to request information, ESMA may be constrained in monitoring effectively activities taking place in a third-country jurisdiction. The CRA speculated that ESMA might be able to identify serious misconduct but may not always detect "small infringements" which are carried out on a regular basis.
38. **ESMA's response:** ESMA will always be in a better position to monitor and assess activities of CRAs carried out within the Union compared to activities carried out outside the Union. However, ESMA considers that the combination of the ability to request information about the conduct of the third-country CRA and the possibility to take supervisory actions against and ultimately impose sanctions on an endorsing CRA which fails to ensure that the conditions for endorsement are met provides for a robust framework. Furthermore, ESMA's monitoring and assessment of the activities of the third-country CRA are complemented by the supervision carried out by the third-country CRA's home country supervisor. As stated in further detail below, periodical and ad-hoc reporting to ESMA about the conduct of the third-country CRA is very important to allow ESMA to undertake a supervisory risk-based approach in monitoring and assessing the compliance of a third-country CRA.

*Date of application of the new approach*

39. Two CRAs requested that ESMA provides a phase-in period in order to allow CRAs to review and potentially adapt their policies and procedures. One CRA asked that consideration is given to a "grandfathering" approach whereby existing ratings do not need to comply with the new guidelines for an extended period of time.
40. **ESMA's response:** ESMA understands that CRAs need appropriate implementation time. To this end, ESMA proposes that the new Guidelines will apply to new ratings or reviews of existing ratings taking place after 1 January 2019. This will provide ESMA with adequate time to provide additional guidance to CRAs about what it considers to be conduct which is as stringent as the relevant provisions in CRAR. This guidance will be limited to areas where policies and procedures of third-country CRAs currently differ from the EU CRAs and where the endorsing CRA has requested that such guidance is provided (see Annex III).

**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?**

41. Several CRAs expressed concerns about the requirements provided in paragraph 13 of the CP Guidelines concerning the ongoing monitoring of the conduct of the third-country CRA, and in particular about the meaning of the notion of “basic checks” on all endorsed credit ratings.
42. One CRA pointed out that EU CRAs are not expected to conduct ‘basic checks’ on ‘every’ credit rating issued in the EU. Instead, CRAR requires that CRAs establish and maintain control environments designed to ensure the production of high quality credit ratings, and to promptly identify and correct issues as they arise. If this approach is satisfactory for credit ratings produced in the EU, it is unclear why something different is required for endorsed credit ratings. Similarly, another CRA stated that an endorsing CRA should be free to choose a governance and monitoring structure that appropriately reflects its particular organisation. Having to conduct basic checks on every endorsed credit rating appears to be out of proportion in light of the considerable number of credit ratings that global CRAs tend to endorse into the EU. Detailed checks on individual endorsed credit ratings should only need to be conducted when issues have been identified by the internal control functions and/or reported to the governance committee and/or supervisory authorities.
43. Finally, one CRA would like to have clarification on the ability of the entire compliance team, wherever located, to assist the EU members of their team with fulfilling any of the tasks related to endorsement that ESMA expects to be undertaken by Compliance or one of the other internal control teams. Without this ability to work as a group, the additional costs imposed by this approach could be burdensome.
44. **ESMA’s response:** As mentioned in paragraph 13 of the CP Guidelines, to be able to fulfil the requirements in Article 4(3)(b) of CRAR, 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. These measures should include, as a minimum, an assessment of the policies and procedures of the third-country CRA and be accompanied by ongoing monitoring of the conduct of the third-country CRA.
45. ESMA considers that it is very important that the measures put in place by an endorsing CRA to monitor the conduct of a third-country CRA are based on appropriate and effective organisational and administrative arrangements and clear decision-making procedures, which allocate roles and responsibilities. In the final Guidelines ESMA provides examples of what such measures could include but agrees that ongoing monitoring can be achieved in different ways as long as it ensures that the endorsing CRA is able to demonstrate to ESMA, on an ongoing basis, that the relevant policies and procedures of the third-country CRA are adhered to. ESMA has specified this in the final text of the final Guidelines. It is important to recall that the obligation to implement measures to monitor the conduct of the third-country CRA was clearly set out in paragraphs 33-35 of the 2011 Guidelines.



46. While an endorsing CRA may choose to outsource these tasks in part or in full to staff in a third-country CRA, this should be done in accordance with Article 9 of CRAR. Furthermore, the endorsing CRA will in any case remain fully and unconditionally responsible and should be satisfied that the monitoring ensures compliance of the conduct of the third-country CRA as required by Article 4(3)(b) of CRAR.
47. One CRA was concerned that the endorsing CRA may not be independent in its assessment of the conduct of the third-country CRA. Being in the same group, the endorsing CRA could have a conflict of interests.
48. **ESMA's response:** ESMA is aware of the possible conflict of interests between the endorsing CRA and the third-country CRA and takes this into account in its risk-based supervisory approach. However, ESMA considers that the infringement laid down in paragraph 1, Section I of Annex III of CRAR is a potent deterrent: A 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. The fine corresponding to this infringement is laid down in Article 36a(2)(a) of CRAR, and amounts to EUR 500 000-750 000 *per endorsed credit rating*.
49. In addition, ESMA can take supervisory measures as laid down in CRAR including requiring a CRA to bring an infringement to an end, issuing public notices and suspending the use of certain credit ratings for regulatory purposes in the EU.

## 2.3 Comments related to Article 4(3)(c)-(d)

### **Q3: Do you agree with ESMA's understanding of points (c) and (d) of Article 4(3) of the CRA Regulation?**

50. Five CRAs responded to the question relating to ESMA's supervisory powers to ask for information from CRAs. Three of them called for ESMA to apply proportionality in its request for periodical and ad-hoc information from an endorsing CRA and be able to justify this based on the expected regulatory or supervisory benefit. These CRAs asked that the reporting requirements regarding the conduct of third-country CRAs are not extended further at this stage as this could result in significant costs to endorsing CRAs. In particular, requirements to periodically report information or data from third-country CRAs through ESMA's reporting system would create significant challenges and costs for endorsing CRAs including potential translation costs as the volume of additional information endorsing CRAs might need to report to ESMA on a regular basis could be very significant. Specifically, reporting of fees charged to clients by third-country CRAs was highlighted as potentially very costly. One of these CRAs considered these reporting requirements disproportionate and not in line with Article 4(3)(d) of CRAR which gives ESMA the power to request from endorsing CRAs certain information only "on request".
51. **ESMA's response:** ESMA considers the request of ad-hoc and periodical reporting to be a key tool for a supervisory risk-based monitoring and assessment of the conduct of a

third-country CRA and its compliance with the requirement laid down in Article 4(3)(b). However, ESMA agrees that any reporting requirement should be proportionate and undertaken in a way which does not lead to unnecessary costs for the reporting entity. The ESMA Guidelines on periodic information to be submitted to ESMA<sup>11</sup> is the appropriate place to specify any periodical reporting requirements relating to the conduct of third-country CRAs and endorsed credit ratings. Consequently, ESMA will not require CRAs to report additional information periodically before those guidelines have been updated.

52. Two CRAs also noted the risk that, in some situations, a CRA may be unable to provide certain pieces of information to ESMA due to restrictions imposed by a third-country regulator or due to contractual limitations, including but not limited to data protection or confidentiality restrictions. For example, some non-EU regulators will state that their express permission is required before forwarding an inspection report or findings letter to another regulator.
53. **ESMA's response:** As stated in paragraph 19 of the final Guidelines, ESMA expects that the endorsing CRA informs ESMA without undue delay of 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 will aim to address the concerns raised in the consultation through its cooperation with third-country supervisors and its internal policies for protecting confidential and personal information. However, if an endorsing CRA is not able to provide critical information to ESMA in accordance with Article 4(3)(c)-(d), it may mean that the conditions for endorsement from the relevant third-country CRA are no longer met.
54. One CRA stressed that ESMA is not supervising the third-country CRA, but simply monitoring and assessing the actions of the third-country CRA (see Article 4(3)(c)), and thus ESMA does not need to require extensive information. Moreover, the CRA asserts that part of ESMA's assessment of the third-country regime involves a determination of the effectiveness of supervision and enforcement in the third country.
55. **ESMA's response:** Should ESMA not have access to the relevant information, ESMA considers that its ability to assess and monitor the compliance of the third-country CRA with the requirements referred to in point (b) is limited within the meaning of Article 4(3)(c). ESMA assesses the effectiveness of the supervisory framework of a third-country supervisor as a part of an equivalence assessment pursuant to Article 5(6)(a) of CRAR. The effectiveness of the third-country supervision is not assessed as condition for endorsement c.f. Article 4(3)(f) (see also paragraph 12 above).

## 2.4 Comments related to Article 4(3)(e)

**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.**

---

<sup>11</sup> ESMA/2015/609 Guidelines on period information to be submitted to ESMA by CRAs

56. All the CRAs that responded to the CP provided their views with regard to section in the Guidelines about objective reasons. The responses focused on four main areas:
- (a) the application of the geographical criterion;
  - (b) broadening the list of objective reasons beyond the geographical criterion;
  - (c) the date of application of the updated guidelines; and
  - (d) the obligation to document objective reasons.

*The application of the geographical criterion*

57. Three CRAs, understood paragraph 19 in the CP Guidelines as requiring CRAs to rate entities and instruments in the country in which they are established. The CRAs argued that ESMA should focus on geographical proximity in terms of regions or financial centres rather than countries.
58. **ESMA's response:** The final Guidelines clarify that all ratings relating to non-EU entities and instruments are considered to fulfil the requirement laid down in Article 4(3)(e). ESMA also clarifies in the final Guidelines that it determines the location of an entity or instrument for the purposes of this requirement in accordance with the RTS on the European Rating Platform (ERP)<sup>12</sup>. Additional objective reasons have been provided with regard to endorsed ratings relating to EU entities and instruments.
59. Three CRAs stressed that ratings of entities and instruments in some cases are closely linked to the rating of one or more companies which are part of the same group. In these cases, it is sensible that the rating of the EU entity is carried out as a part of a group wide analysis by a single team of analysts.
60. **ESMA's response:** ESMA considers that the described scenario is comparable to a situation where the rated entity itself is a non-EU entity. In the interest of rating quality, it may be preferable to analyse large groups in a consistent manner. Consequently, ESMA would consider it an objective reason for endorsement when the endorsed credit rating relating to an EU entity or instrument is dependent on the rating of a significant subsidiary or parent company located outside the EU.

*Broadening the list of objective reasons beyond the geographical criterion*

61. Three CRAs asked for further broadening of the list of objective reasons in the interest of transparency and level playing field. One of the CRAs pointed out that while Article 5 of CRAR, which deals with equivalence and certification, specifies that this regime applies to

---

<sup>12</sup> Commission delegated Regulation 2015/2 of 30 September 2014 with regard to regulatory technical standards for the presentation of the information that CRAs make available to ESMA, available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2015.002.01.0024.01.ENG](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.002.01.0024.01.ENG)

“credit ratings that are related to entities established or financial instruments issued in third countries”, there is no geographical restriction set out in Article 4 of CRAR. The same CRA preferred a non-exhaustive list to ensure flexibility as opposed to another CRA which, furthermore, proposed that ESMA publishes objective reasons provided by CRAs when they are accepted by ESMA but not included in the list provided in these Guidelines.

62. **ESMA’s response:** ESMA agrees that objective reasons are not limited to the geographical location of a rated entity or instrument and ESMA is committed to transparency in the application of this requirement. Consequently, following the arguments proposed by CRAs, in the final version of the Guidelines, ESMA has provided more circumstances that can be considered as objective reasons within the meaning of Article 4(3)(e) of CRAR. However, at the same time, ESMA is of the view that the business model of an EU CRA cannot be aimed at providing a majority of its ratings relating to EU entities and instruments through endorsement on a permanent basis. ESMA is of the opinion that this might constitute use of endorsement with the intention of avoiding the requirements of this Regulation which is prohibited in Article 4(4) of CRAR.
63. More generally, it is ESMA’s view that objective reasons cannot be dependent on the will or choice of a CRA. Managerial reasons taken per se and without any other reference to a co-existing reason which is independent of the CRA’s will or choice imply a subjective element and can therefore not be considered “objective” reasons.
64. With regard to the proposal to publish objective reasons recorded by CRAs, ESMA is not empowered to do so. However, ESMA will consider updating these guidelines if it finds that specific reasons, not explicitly set out as examples in the Guidelines, will be accepted going forward.
65. Other reasons mentioned by CRAs included the location of an issuer cohort or peer group, sector or industry-specific expertise of a specific analyst for a specific transaction or issuer, development of centres of excellence for knowledge sharing among credit analysts, sectoral or specific expertise in a third country (including language skills). In addition, a number of CRAs mentioned talent pool and availability of qualified staff as an objective reason.
66. **ESMA’s response:** ESMA is of the opinion that these reasons cannot be considered objective reasons for endorsement on a stand alone basis. ESMA has clarified in the final guidelines that location of specialised staff in some circumstances can be considered an objective reason.
67. A CRA also mentioned the location of agents, advisers and intermediaries, location of relevant transaction assets and management groups, effective communication with issuers and investors, ease of establishment for CRA, governance framework of CRA to rate an entity or instrument from a certain location and location of and proximity to investors and other key market participants as examples of objective reasons.
68. **ESMA’s response:** The location of the rated entity or the issuer of a rated instrument could be considered an objective reason. In the case of a structured finance instrument,

the location of the majority of the underlying assets would be relevant as per Article 5(4) of the RTS on the ERP. The governance framework of a CRA cannot be considered an objective reason on a stand-alone basis and never on a permanent basis, as it is controlled and shaped by the CRA.

*The date of application of the updated guidelines*

69. Two CRAs asked that the objective reasons underlying already endorsed ratings would not have to be reviewed under the new regime and that sufficient time would be provided to allow CRAs to adapt.
70. **ESMA's response:** As stated above, ESMA is mindful of the need to provide CRAs with sufficient time to adapt. That is why the updated Guidelines will only apply to credit ratings issued on or after 1 January 2019 and to existing credit ratings reviewed after that date. ESMA observes that the vast majority of endorsed credit ratings relate to non-EU entities and instruments and that the actual number of outstanding credit ratings for which the objective reason would need to be reviewed is limited.

*The obligation to document objective reasons*

71. As regards documentation of objective reasons, one CRA stated that documenting this on a rating-by-rating basis would be too burdensome.
72. **ESMA's response:** ESMA does not see how the requirement in Article 4(3)(e) can be met if a CRA does not document the objective reasons for endorsement. Often, an objective reason will not be specific to an individual credit rating but to groups of ratings relating to groups of entities and their issuances or relating to asset classes. Finally, as stated above, endorsed ratings relating to non-EU entities and instruments are considered to meet the requirement laid down in Article 4(3)(e).

## 2.5 Comments related to the general requirements

### **Q5: Do you agree that the endorsing CRA should comply with the general requirements as listed in this section?**

73. One CRA was favourable of the reporting requirements proposed by ESMA, whereas two CRAs were more skeptical, expressing general concerns about the volume of data that it is required to submit to ESMA. The CRAs opposed any further extension of periodic reporting regime. One of them, was specifically concerned about the periodic reporting requirements in paragraph 23 of the CP Guidelines and considered it to be disproportionated and not in line with Article 4(3)(d) of CRAR.
74. **ESMA's response:** ESMA considers that Article 4(3)(c) provides ESMA with the legal basis to require both periodical and ad-hoc reporting to ESMA about the conduct of the third-country CRA. However, ESMA agrees that such requirements should be proportionate and undertaken in a way which does not lead to unnecessary costs for the reporting entity. In the interest of transparency and consistency, ESMA proposes to set

out the specific periodic reporting requirements relating to the conduct of a third-country CRA in the guidelines on periodic reporting during the next update of these guidelines. This will follow a public consultation at which point CRAs will be able to respond to concrete ESMA's proposals. As a consequence, ESMA has deleted references to specific periodical reporting requirements in these guidelines and moved the remaining parts of the section "General Requirements" to the beginning of the final Guidelines.

## 2.6 Other comments

75. A number of respondents raised issues which were not directly related to the questions listed in the CP. These comments are presented in this section.
76. One CRA expressed appreciation that ESMA is bringing clarity to its approach to endorsement. At the same time, the CRA also warned that the endorsement regime can be undermined if ESMA's approach to third-country branches of EU-CRAs is not sufficiently transparent for the rating users. The CRA argues that it might be difficult for ESMA to assess the functioning of those branch offices as they can be located in third-countries outside the EU which are not equivalent in regulatory terms. The low probability of in-house checks of third-country branch offices may raise the risk of conflicts of interests.
77. **ESMA's response:** ESMA's approach to third-country branches is laid down in section VI in its Guidelines on the Scope of CRAR<sup>13</sup>. Further information about ESMA's view on the establishment of third-country branches is also addressed in the ESMA opinion "General principles to support supervisory convergence in the context of the United Kingdom withdrawing from the European Union"<sup>14</sup> published 31 May 2017. If deemed necessary, ESMA will provide further guidance on third-country branches of EU CRAs in the course of 2018.
78. One CRA believed that ESMA should not be directly concerned with the domicile of a third-country CRA but should focus on the regulatory regime under which it operates. So for example, post-BREXIT, in the event that a UK-based CRA is then deemed to be in a third country, prior to UK equivalence being confirmed, ratings produced by such UK-based CRA (under a global methodology) should be capable of being endorsed into the EU by a subsidiary within the same group by virtue of the UK-based CRA's status (if it exists) as registered with the US supervisor of CRAs and the US being an existing equivalent regime. This would seem to be a pragmatic approach to an issue that might otherwise cause confusion amongst users of ratings, irrespective of whether such a scenario was contemplated by the original regulation. As a consequence of being assigned NRSRO status, UK-based CRAs are required to comply with US Regulation and so, it is not clear

---

<sup>13</sup> Published 30 July 2013. ESMA/2013/720, available at: [https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-720\\_en.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-720_en.pdf)

<sup>14</sup> Published 31 May 2017. ESMA42-110-433, available at: <https://www.esma.europa.eu/press-news/esma-news/esma-issues-principles-supervisory-approach-relocations-uk>

why it is felt that such an arrangement would not provide the same safeguards as exist in respect of ratings issued by a CRA domiciled in the US.

79. **ESMA's response:** As a condition for endorsement, Article 4(3)(f) of CRAR sets out that: "the CRA established in the third country is authorised or registered, and is subject to supervision, in that third country". ESMA does not consider this condition to be met if the third-country CRA is not established in the third-country in which it is authorised or registered and subject to supervision.
80. One association of CRAs argued that equivalence should be granted on condition of reciprocity. The European Union should only accept ratings issued in a third-country if that country recognises ratings issued by EU CRAs.
81. **ESMA's response:** The notion of reciprocity is not provided for in CRAR. This is, therefore, a matter to be decided by the legislator.

## 3 Cost-Benefit Analysis

### 3.1 Executive Summary

82. In carrying out its functions under CRAR, ESMA is responsible for ensuring that credit ratings issued in the European Union are of a high quality and contribute to investor protection and the smooth functioning of the internal market.
83. A key part of this function is ensuring that endorsed credit ratings are of the same quality as non-endorsed credit ratings. To carry out this responsibility, ESMA is empowered to issue and update Guidelines on the application of the endorsement regime. The proposed Guidelines on endorsement are therefore an important part of ESMA's supervisory tool-kit.

### 3.2 Reasons for Publication

84. As set out in Article 2 of CRA 3 a number of requirements introduced by the CRA 3 Regulation will apply for the purposes of the endorsement regime under Article 4(3)(b) from 1 June 2018. For these reasons, ESMA found it necessary to update its 2011 Guidelines on endorsement in order that they reflected these new developments.
85. In updating these Guidelines ESMA has clarified certain aspects of the functioning of the endorsement regime, and it is from these clarifications of existing CRA Regulation requirements that ESMA believes additional compliance costs may arise for those CRAs who endorse credit ratings from third countries.

### 3.3 Impact of the Guidelines

86. For all CRAs, both EU and non-EU the updated Guidelines clarify what external pre-conditions need to be met before credit ratings can be endorsed into the EU from a third country. These include a positive assessment of the third countries' legal and supervisory framework, an assessment of the conditions relating to the CRA intending to endorse credit ratings as well as the existence of a MoU of cooperation with that third country's supervisor.
87. For EU registered CRAs specifically, the Endorsment Guidelines provide guidance on the objective reasons ESMA considers valid for justifying the elaboration of a credit rating outside the EU. The Guidelines also provide guidance as to what operational measures ESMA expects an EU CRA to put place vis-a-vis the third country CRA that will be elaborating the credit ratings in order to ensure the ongoing monitoring of credit rating activities.
88. For third-country CRAs and supervisors, the new Guidelines also provide transparency regarding the methodological framework ESMA follows when assessing whether a legal and supervisory framework may be judged as meeting the conditions for endorsement.



## 3.4 Baseline

89. From a legal perspective, the legislation to consider is:
- (a) Article 4(3) of CRAR which set out the general requirements that must be met by an EU CRA in order to endorse credit ratings into the EU.
  - (b) Article 21(3) of CRAR which empowers ESMA to issue and update Guidelines on the application of the endorsement regime.
  - (c) Article 2 of CRA 3 Regulation which requires the entry into force of a number of CRA 3 provisions for the purpose of the endorsement regime from 1 June 2018.
  - (d) Point 1 of Section I of Annex III of CRAR which sets out the infringement applicable to a credit rating agency that infringes Article 4(3) by endorsing a credit rating issued in a third country without complying with the conditions set out in that paragraph.
90. In considering the various costs and benefits it is relevant to note that the baseline scenario of no-action or status quo was not considered tenable, given that CRAR specifies that additional CRA 3 requirements enter into force for the purposes of endorsement from 1 June 2018.
91. In this regard, the expected additional compliance costs implied by the updated Guidelines can be grouped into three categories (i) initial/one off (ii) ongoing and (iii) ad-hoc. Taking these in turn, an initial one off cost is expected to be borne by all CRAs as a result of the required assessments of the practices of the third country CRA from which it intends to endorse credit ratings. Ongoing costs are expected to arise from the required monitoring an EU CRA is expected to carry out on the activities of the third country CRA. Further costs may be incurred as a result of IT reporting requirements relating to endorsed credit ratings. In addition to these one off and ongoing costs, the Guidelines may also impose additional ad-hoc costs, where ESMA chooses to exercise its right to request specific information on endorsed credit ratings.
92. Regarding the one off costs associated with the initial assessment of the policies and procedures of the third-country CRA, ESMA expects the cost per assessment is likely to be the same for each CRA. As a result, the total implied cost for each CRA will depend on the number of third country CRAs for which an assessment needs to be conducted.
93. Likewise, for ongoing monitoring costs these are likely to be lower for groups of CRAs that are currently implementing global policies and procedures across jurisdictions in which there are only minor differences. On the other hand, groups of CRAs currently implementing global policies and procedures across jurisdictions with significant differences in the policies and procedures of third country CRAs, are likely to face higher ongoing monitoring. In this regard, the determining factor in the total ongoing costs will be the size and complexity of the CRA's business model.

- 94. For both of these categories, initial and ongoing, the additional compliance costs will therefore be determined by the size and complexity of the CRA’s own business model. Whereas for ad-hoc, the costs will be determined by ESMA’s risk-based approach to supervision.
- 95. As a result, ESMA believes that any potential impact of these additional costs will not only be mitigated by their inherent proportionality but are also justifiable on the basis that they are longstanding requirements of CRAR. Further justification for these costs is supported by the size of the fine applicable for failing to ensure a single credit rating does not adhere to the requirements of Article 4(3).
- 96. In terms of increased costs for ESMA, it is expected that the materiality of these costs will be constrained by the adoption of a risk-based approach to supervision. ESMA also expects that any additional increase in staff costs is justified in order to ensure that EU consumers, investors and market participants benefit from a rigorous supervisory regime for credit ratings.

**3.5 CBA**

- 97. The purpose of this section is to provide a CBA comparing the potential costs and benefits resulting arising from the Guidelines. Given the lack of available quantitative evidence on the expected application of the Guidelines, one element that ESMA has used to judge the potential costs is the size of the fine proposed by CRAR for failing to ensure a credit rating adheres to the requirements of Article 4(3).

<b>Policy objective</b>	<ul style="list-style-type: none"> <li>- Provide clear guidance on the functioning of the Endorsement regime under CRAR.</li> <li>- Guarantee that credit ratings endorsed <u>into</u> the EU continue to meet the same high standard of investor protection as those credit ratings elaborated inside the EU.</li> </ul>
<b>Technical proposal</b>	<p>ESMA’s Guidelines on the Endorsement regime for credit ratings provide important guidance relevant to:</p> <ul style="list-style-type: none"> <li>i. EU CRAs who endorse credit ratings into the EU from third countries;</li> <li>ii. third country CRAs who elaborate credit ratings that are endorsed into the EU by EU CRAs;</li> <li>iii. third country supervisors who supervise CRAs that elaborate credit ratings that are endorsed into the EU.</li> </ul>
<i>Benefits</i>	<p>ESMA expects the proposed Guidelines will benefit EU CRAs, third-country CRAs and the users of ratings by:</p>



	<p>jurisdiction where those applicable in the third-countries are less stringent than the EU requirements. However, for CRAs operating under global policies and procedures, ESMA is not expecting major impact.</p> <p><b>Following the successful completion of an initial assessment, the CRA will be obliged to monitor the conduct of the third-country CRA on an ongoing basis.</b></p> <p>While ESMA provides examples of what this may entail, ESMA leaves it to the CRA to organise itself in the way it sees most fit. Since the requirement to verify the compliance of the conduct of the third-country CRA was clearly set out in the 2011 Guidelines (e.g. paragraphs 34 and 35), ESMA expects that CRAs are already undertaking such activities. Additional compliance costs are therefore, expected to be small.</p> <p>CRAs are also required to review and assess any material changes to the relevant policies and procedures in the third-country CRA. .</p>
<b>Cost to supervisor</b>	<p>It is likely that ESMA will incur additional staff costs supervising the conduct of EU CRA's assessments of third country CRAs policies and procedures, as well as EU CRA's ongoing monitoring of the conduct of relevant third country CRAs.</p> <p>In addition, it is likely that ESMA will incur additional staff costs as a result of increased scrutiny given to the supervision of endorsed ratings and the activities of third country CRAs.</p>

# **Annex I: 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 agencies<sup>15</sup> (hereinafter “CRAR”) 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 concern particular matters relating to credit ratings issued in third countries and endorsed pursuant to Article 4(3) of CRAR. 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 apply to credit ratings issued on or after 1 January 2019 and to existing credit ratings reviewed after that date.

---

<sup>15</sup> OJ L 302, 17.11.2009, p.1.

## Definitions, legislative references and acronyms

The following definitions apply:

CRA	Credit rating agency
CRAR	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	European Securities and Markets Authorities
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)
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 CRAR.
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 CRAR '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 endorsement provisions of CRAR	The provisions quoted in Article 4(3)(b) of CRAR: Articles 6 to 12 and Annex I of CRAR with the exception of Articles 6a, 6b, 8a, 8b, 8c, 8d and 11a, point (ba) of point 3 and points

	3a and 3b of Section B as well as part III of Section D of Annex I of CRAR.
--	---

## 2 Purpose

4. CRAR entered into force on 7 December 2009. The amendments introduced by CRA 2 empowered ESMA to undertake the supervision of all CRAs 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) of CRAR 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 CRAR. 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 Article 4(3) of CRAR.

## 3 Compliance and reporting obligations

### 3.1 Status of the guidelines

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

### 3.2 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.

## 4 Guidelines

### 4.1 Initial conditions for endorsement

9. An EU CRA should not begin endorsing credit ratings before ESMA has completed two separate assessments, namely: (1) an assessment of the conditions relating to the legal and supervisory framework of the third country as described in Annex II (the Methodological Framework for Endorsement); and, (2) an assessment of certain conditions relating to the CRAs intending to endorse credit ratings.

## 4.2 Ongoing obligations of an endorsing CRA

10. ESMA expects that an endorsing CRA notifies ESMA if it becomes aware that one or more of the conditions initially assessed by ESMA are no longer fulfilled. As a good practice, the internal audit function should regularly review the control environment for endorsement.
11. In addition, an endorsing CRA should ensure that it meets the following requirements on an ongoing basis.

### **Requirements relating to Article 4(3)(b)**

12. 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 CRAR with the exception of Articles 6a, 6b, 8a, 8b, 8c, 8d and 11a, point (ba) of point 3 and points 3a and 3b of Section B as well as part III of Section D of Annex I of CRAR (hereinafter “the relevant endorsement provisions of CRAR”).
13. 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 endorsement provisions of CRAR. 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 on an ongoing basis.
14. Where the third-country CRA chooses to directly fulfil the requirements set out in the relevant endorsement provisions of CRAR, ESMA does not expect the endorsing CRA to demonstrate that the third-country CRA has established internal requirements which are as stringent as the relevant EU requirements. 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.
15. To be able to fulfil the requirements described above, ESMA expects that the endorsing CRA has put in place measures to:
  - (a) monitor the policies and procedures of the third-country CRA: Such measures should include an initial assessment of the relevant policies and procedures in the third-country CRA, which should be carried out to ensure that they meet the requirements in Article 4(3)(b) of CRAR. Any subsequent material changes to the relevant policies and procedures in the third-country CRA should also be reviewed and assessed.
  - (b) monitor the conduct of the third country CRA: such measures should ensure that the endorsing CRA is able to demonstrate to ESMA on an ongoing basis that the relevant policies and procedures of the third-country CRA are adhered to, for example through basic automated checks, periodic deep dive assessments of the compliance of a sample of endorsed credit ratings with



specific requirements or areas of requirements and/or review of documentation produced by the key control functions of the third-country CRA.

16. 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.
17. Whenever the endorsing CRA finds that the conduct of the third-country CRA may not fulfil requirements which are as stringent as the relevant endorsement provisions of CRAR, ESMA expects that the endorsing CRA informs ESMA and takes appropriate steps. The 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.

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

18. With regard to point (c) of Article 4(3) of CRAR, 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).
19. 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.
20. With regard to point (c)-(d) of Article 4(3) of CRAR, when requested, in order to supervise EU CRAs on an ongoing basis, ESMA expects that the endorsing CRA provides any relevant information relating to an endorsed credit rating or the conduct of the third-country CRA.

## Requirements relating to Article 4(3)(e)

21. ESMA considers that the following should, inter alia, be considered objective reasons within the meaning of Article 4(3)(e):
- (a) when a rated entity or instrument is non-EU<sup>16</sup>;
  - (b) when an endorsed credit rating relating to an EU entity or instrument is dependent on the rating of a subsidiary or parent company of the rated entity which is non-EU;
  - (c) when only a small part of a CRA's outstanding ratings in a narrowly defined asset class are EU entities or instruments and when analytical staff specialised in this asset class is based outside the EU. However, a CRA should continually ensure that it has specialised analytical staff based in the EU in proportion to the relevance of the asset class in the EU; and
  - (d) when an event occurs that temporarily impacts the allocation of analytical capacity of a group of CRAs, such as in the following cases:
    - i. A CRA has only recently opened an EU office and the staff that have the experience to rate some EU entities or asset classes are not yet based in the EU.
    - ii. A corporate action such as a takeover or merger, if the rating activity no longer reflects the new corporate structure.
    - iii. Absence of key analytical staff which could not reasonably have been foreseen or planned for.
22. In order to rely on objective reasons referred to in paragraph 21(d), a CRA should be able to demonstrate to ESMA that it is taking the necessary steps to enable the gradual transfer of these ratings to the EU.
23. The endorsing CRA should notify ESMA when the objective reasons for elaborating endorsed credit ratings outside the EU, deviate from those indicated to ESMA. 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 and verifies periodically that the indicated objective reason for an outstanding endorsed credit rating remains valid.

---

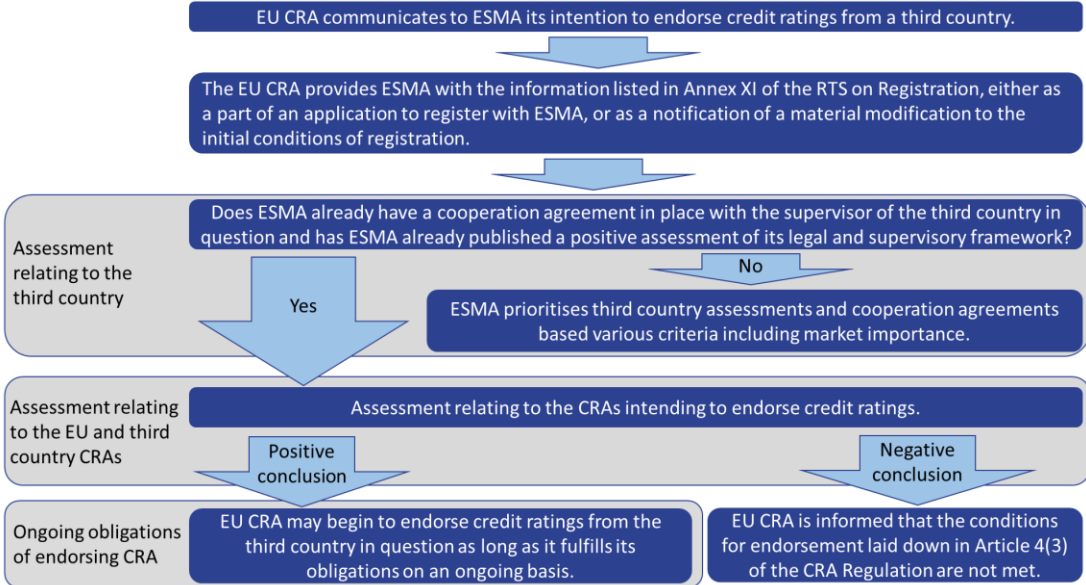
<sup>16</sup> For the purposes of these Guidelines, the country of an entity or financial instrument follows Articles 4-6 as well as Field 10 of Table 1 of Part 2 of Annex I of the Commission delegated Regulation 2015/2 of 30 September 2014 with regard to regulatory technical standards for the presentation of the information that CRAs make available to ESMA, available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2015.002.01.0024.01.ENG](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.002.01.0024.01.ENG)

# Annex II: Methodological framework for assessing a third country supervisory and legal framework for the purpose of endorsement

## 1 Background: The process of approving endorsement from a third country

1. Where an EU CRA intends to endorse credit ratings issued in third countries, it must communicate to ESMA its intention to do so either in its application for registration or as material change to the initial conditions of registration. As set out in paragraph 9 of these Guidelines, an EU CRA should not begin endorsing credit ratings, before ESMA has completed two separate assessments: (1) an assessment of the conditions relating to the legal and supervisory framework of the third country including the existing of a cooperation agreement between ESMA and the third-country supervisor (the third-country assessment) as and (2) an assessment of the conditions relating to the CRAs intending to endorse credit ratings. Subsequent to these 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 CRAR.
2. The result of the third-country assessment is made publicly available on ESMA’s website. Once published, the third-country assessment can be relied upon by all EU CRAs intending to endorse credit ratings from that third country. The result of the second assessment is communicated directly to the applicant CRA.
3. The below figure summarises the process of approving endorsement from a third-country.

FIGURE 1. THE PROCESS OF APPROVING ENDORSEMENT FROM A THIRD COUNTRY



## 1.1 Assessment relating to the third-country legal and supervisory framework

4. ESMA's third-country assessment is carried out in accordance with the methodological framework set out in Section 2 to this Annex. It verifies that the following conditions for endorsement are met:
  - there is a supervisor in the third country which authorises or registers CRAs and subjects them to ongoing supervision. For this condition to be met, ESMA considers that there should be a legal and supervisory framework for supervision of CRAs in the third country providing a level of protection which is comparable to CRAR (Article 4(3)(f) and (h) of CRAR);
  - 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 CRAR); and
  - ESMA has established a cooperation agreement with the supervisor of the third country (Article 4(3)(h) of CRAR).

## 1.2 Assessment of certain conditions relating to the CRAs intending to endorse credit ratings

5. ESMA's assessment relating to the CRAs intending to endorse credit ratings verifies that the following conditions for endorsement are met:
  - 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 CRAR);
  - 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 CRAR as explained further in paragraph 15 of these Guidelines);
  - 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 CRAR as explained further in paragraphs 21-23 in these Guidelines); and
  - the EU CRA can provide evidence that that the third-country CRA is authorised or registered in the third country where it is established (Article 4(3)(f) of CRAR).

## 1.3 Summary of the conditions for endorsement

6. 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.

7. The symbol “✓” indicates when a requirement is assessed. The exclamation mark “!” indicates that an endorsing CRA is expected to notify ESMA without undue delay if it becomes aware that the conditions initially assessed by ESMA are no longer met.

**FIGURE 1: CONDITIONS FOR ENDORSEMENT**

Relevant Level 1 provision	Conditions laid down in Article 4(3)	Assessment, which ESMA undertakes before a CRA starts endorsing, relating to...		Ongoing obligations of endorsing CRA
		...the third country	...the endorsing and third-country CRAs	
4(3)(a)	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.		✓	!
4(3)(b)	The endorsing 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.		✓	!
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)	The endorsing CRA has documented an objective reason for elaborating every single endorsed rating in a third country.			✓
4(3)(e)	the EU CRA has provided ESMA with an indication of the objective reasons for credit ratings to be elaborated in a third country.		✓	!
4(3)(f)	The EU CRA can provide evidence that that the third-country CRA is authorised or registered in the third country where it is established.		✓	!
4(3)(f) and (h)	There is a supervisor in the third country which authorises or registers third-country CRAs and subjects them to supervision. For this condition to be met there should be a legal and supervisory framework for supervision of CRAs in the third-country which is comparable to the EU framework.	✓		!
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.	✓		!
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.	✓		

## **2 Methodological framework for assessing a third-country supervisory and legal framework for the purposes of endorsement**

1. For the purposes of this assessment, ESMA has grouped the requirements from CRAR into different sections depending on the objective each provision seeks to address. These sections are discussed in further detail below and are as follows:
  - 2.1 Scope of the regulatory and supervisory framework
  - 2.2 Corporate governance
  - 2.3 Conflicts of interest management
  - 2.4 Organisational requirements
    - 2.4.1 General organisational requirements
    - 2.4.2 Outsourcing
    - 2.4.3 Confidentiality
    - 2.4.4 Record Keeping
  - 2.5 Quality of methodologies and quality of ratings
    - 2.5.1 Reviewing credit ratings, methodologies, models and assumptions and information used in issuing ratings
    - 2.5.2 Knowledge and experience of employees directly involved in credit rating activities
    - 2.5.3 Quality of credit ratings and analysis of information used in assigning credit ratings
    - 2.5.4 Quality of methodologies and changes to them
  - 2.6 Disclosure
    - 2.6.1 Presentation and disclosure of credit ratings
    - 2.6.2 General and periodic disclosure about the CRA
  - 2.7 supervision and enforcement
    - 2.7.1 The methods that the third-country authority has in place to ensure that it is adequately staffed
    - 2.7.2 Powers of the third country authority
    - 2.7.3 Sanctions

## 2.1 Scope of the legal and supervisory framework

2. The purpose of assessing the legal and supervisory framework of a third country is to determine whether that framework achieves the same objectives in practice as the EU framework. If ESMA is not satisfied that a framework achieves these objectives, then a positive conclusion cannot be reached.
3. In this regard, the following elements need to be in place in order to meet the initial requirements for endorsement:
  - (a) CRAs are subject to some form of registration or authorisation process as well as ongoing supervision (Articles 4(3)(f) of CRAR);
  - (b) The above requirement as well as Article 4(3)(h) presuppose that there is some form of legally binding regulatory and supervisory framework for CRAs in place;
  - (c) 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 CRAR);
  - (d) the relevant authority is prohibited from influencing the content of ratings and methodologies (Articles 4(3)(g) of CRAR).
4. In respect of the points above, point a) is further developed in subsection 2.7 below regarding what ESMA considers needs to be in place for ongoing supervision.
5. Of the other requirements set out in paragraph 2 above, it is point c) 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 CRAR covers. While CRAR 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.
6. 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 CRAR.
7. Looking at the requirements of CRAR, this means that the definition of a CRA or the activities that it conducts do not need to be identical, but they need to have requirements regarding independence, conflicts of interest, quality of methodologies, disclosure of ratings, confidentiality of information and record keeping which are comparable to CRAR.
8. ESMA will look at the legal definition of what a CRA is, what activities are covered and also at the nature of the exemptions that can be applied.
9. 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. A definition of

CRAs, which is broader in scope than the EU definition, is acceptable for the purpose of endorsement.

10. 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 CRAR (referred to as “use for regulatory purposes” in this document) need to be registered or authorised.
11. ESMA highlights that Articles 4 of CRAR 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. 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. In cases where the third-country legal and supervisory framework is broad for the purpose of 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*

12. 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.
13. It is acceptable that there are no exemptions set out in the third-country legal and supervisory framework because, the exemptions allowed under CRAR 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 requirements.
14. 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.
15. 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.

## 2.2 Corporate governance

16. Corporate governance is a core aspect of CRAR and as such sets out a large number of detailed and prescriptive requirements in Article 6 and Section A of Annex I of CRAR.
17. ESMA considers that the key objectives of CRAR’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.
18. ESMA points out that, as set out in recitals 28, 29 and 30 of CRA I, corporate governance arrangements are necessary to ensure that credit ratings are independent, objective, and of adequate quality.
19. ESMA considers that there, as a minimum, needs to be some form of requirement established by law in the third-country that a corporate governance structure is in place to ensure that senior management is accountable and ensures monitoring by someone who is independent 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 of the following:
- (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; and
  - (d) compliance and governance processes.

## 2.3 Conflicts of interest management

20. ESMA deems that conflicts of interest management is a core requirement of CRAR in order to ensure that it meets the overall objective.
21. ESMA considers the objectives of the conflicts of interest management requirements of CRAR 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.
22. CRAR sets out a number of detailed requirements that have to be met by CRAs in order to ensure that these objectives are achieved in Article 6, Article 7(2)-(5) and Sections A, B, and C of Annex I. In addition to those aspects of conflicts of interest covered in the corporate governance section above, ESMA considers that the third-country legal framework should, as a minimum, require a CRA to:
- (a) be organised in a manner that ensures that its business interests do not impair the independence and accuracy of its credit rating activities;

- (b) establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate, or manage and disclose any conflicts of interest;
  - (c) identify, eliminate, or manage and disclose clearly and prominently any actual or potential conflicts of interest;
  - (d) ensure that the provision of ancillary services do not present conflicts of interest with its credit rating;
  - (e) 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;
  - (f) 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;
  - (g) have requirements whereby those who know of illegal conduct by others report it to the compliance officer without negative consequences; and
  - (h) 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.
24. In addition to the above, 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. Furthermore, rating analysts are prohibited from engaging in transactions in financial instruments issued, guaranteed or otherwise supported by the rated entity.
23. ESMA believes that conflicts of interest management is fundamental to the ability of CRAR to achieve its objectives and does expect, that there are robust provisions reflected in the law that cover actual or potential conflicts of interest management and disclosure.
24. As such, ESMA considers that, in addition to those aspects of corporate governance set out in paragraphs 16 to **Error! Reference source not found.**, overall, the objectives of each individual conflict of interest management requirement described in paragraphs 20 to 24 above should be met through provisions reflected in the third-country legal and regulatory framework, together with proper supervision.

## 2.4 Organisational requirements

25. 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.

26. CRAR 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.

27. These requirements can be divided as follows:

- I) General organisational requirements;
- II) Outsourcing;
- III) Confidentiality; and
- IV) Record keeping.

#### 2.4.1 General organisational requirements

28. Article 6(2) and paragraphs (3)-(6), (8), (10) of Section A of Annex I of CRAR requires establish general organisational requirements. The local regulatory framework should at least require a CRA to:

- (a) establish adequate policies and procedures that ensure compliance of its obligations under the relevant legislation;
- (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; and
- (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.

29. ESMA considers that the above mentioned requirements are necessary to facilitate the CRA's ability to achieve the objectives set out in paragraph 25 above, although it does not expect the identical requirements to be hard wired into a third-country regulatory framework.

30. 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 below.
31. 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 reach the initial condition for endorsement.
32. In this regard, ESMA may 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 in place.

#### 2.4.2 Outsourcing

33. Article 9 of CRAR 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 CRAR.
34. In assessing this prohibition for endorsement purposes, it should be clear:
  - (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.
35. In respect of these requirements, ESMA considers that, where outsourcing is allowed in the third country, the third-country regulatory framework should 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.
36. 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.

### 2.4.3 Confidentiality

37. 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.
38. CRAR 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 CRAR. ESMA expects that at least the following requirements are established by law in the third-country:
  - (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; and
  - (d) to not use or share confidential information for trading purposes or any other purpose other than credit rating activities.

### 2.4.4 Record Keeping

39. Effective record keeping enables a CRA to document the manner in which it meets its legal obligations, as well as allows its regulator to supervise that this is being done.
40. Article 6(2) and paragraphs (7)-(9) of Section B of Annex I of CRAR 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.
41. 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.

## 2.5 Quality of Methodologies and Quality of Ratings

42. In addition to the general organisational requirements referred to above, CRAR 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 CRAR); and
  - (d) that ratings and methodologies are subject to validation as well as the adequate quality and thoroughness of ratings.
43. 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 CRAR, 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; and
  - IV) Quality of methodologies and changes to them.

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

44. CRAR 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.
45. The local legal framework should at least ensure that CRAs:
- (a) have staff devoted to the periodical review of methodologies, models, key rating assumptions, independent from those that are responsible for the development and use of these methodologies, key rating assumptions and models;
  - (b) monitor its ratings and methodologies on an on-going basis; and
  - (c) review the affected credit ratings as soon as possible.
46. ESMA considers it important that methodologies are up-to-date and subject to a comprehensive review on a periodic basis.

#### 2.5.2 Knowledge and experience of employees directly involved in credit rating activities

47. CRAR sets out requirements relating to the knowledge and experience of CRA's employees directly involved in credit rating activities in Article 7(1). Specifically, CRAs have to ensure 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.

48. 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.

### 2.5.3 Quality of credit ratings and analysis of information used in assigning credit ratings

49. CRAR 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.
50. These requirements are set out in Articles 8(2), 8(5), 10(2), and part I of Section D of Annex of CRAR. ESMA considers, the that the following requirements should at least be reflected in the regulatory framework:
- (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; and
  - (c) 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.
51. ESMA considers these requirements are important for the purpose 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.

### 2.5.4 Quality of methodologies and changes to them

52. CRAR 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 CRAR. ESMA considers that at least the following should be in place in regulatory framework of the third country:
- (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.

## 2.6 Disclosure

53. 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 requirements.
54. For the purpose of endorsement, ESMA has subdivided CRAR's disclosure requirements as follows:
  - I) Presentation and disclosure of credit ratings.
  - II) General and periodic disclosure about the CRA.

### 2.6.1 Presentation and disclosure of credit ratings

55. In light of the number of presentation and disclosure of ratings requirements, ESMA has further categorised 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**

56. CRAR 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.
57. Article 10(1), (4), (5), (6) Article 11(2), and paragraph (5) of Section D of Annex I of CRAR sets out certain requirement of which at least the following should be in place in the third-country legal framework, CRAs are required to:
  - (a) disclose any 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; and
  - (d) when announcing a credit rating, to explain in their press releases or reports the key elements underlying the credit rating.
58. In addition, according to Article 8(2), 8(2a), 10(2)-(2a) and paragraphs (1), (2), (4) of Section D of Annex I of CRAR, CRAs should ensure that a range of information is



indicated in the credit ratings or rating outlooks. At least the following should be established by law in the third-country:

- (a) 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;
- (b) the principal methodology or methodology version that was used in determining the rating, with a reference to its comprehensive description; and
- (c) 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.

## 2.6.2 General disclosure about the CRA

- 59. In addition to the requirements on disclosure and presentation of credit ratings, CRAR 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.
- 60. ESMA considers that the objectives of the general disclosure requirements of CRAR 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 purpose of on-going supervision.
- 61. According to Article 11(1) and Part I of Section E of Annex I of CRAR, a CRA is required to generally disclose to the public a range of information. For the purpose of this assessment, ESMA expects at least the following to be in place:
  - (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 methodologies, and descriptions of models and key rating assumptions as well as their material changes; and
  - (e) where relevant, its code of conduct.
- 62. Furthermore, 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, concerning, among others, the compensation arrangements, fees and the pricing policy.

## 2.7 Supervision and enforcement

63. Article 4(3)(f) of CRAR include as preconditions for endorsement that the CRA established in the third country is authorised or registered, and is subject to supervision in that third country. In addition, the coordination arrangements that need to be in place in accordance with Articles 4(3)(h) have to include provisions relating to the “coordination of supervisory activities...”. Both requirements presuppose the existence of a supervisor undertaking supervisory activities on an ongoing basis.
64. The following provides a fixed set of criteria for assessing a third-country supervisory regime. 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.
65. 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.

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

66. 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.
67. Article 22(2) of CRAR requires that competent authorities in the EU be adequately staffed, with regard to capacity and expertise, in order to be able to apply CRAR. ESMA does not expect to find a similar legal provision but ESMA does expect that there will be an adequate number of staff.
68. Without the necessary staff there cannot be “ongoing 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.

### 2.7.2 The powers of the relevant authority

69. Articles 23b-23d of CRAR sets out the details of the powers ESMA has order to be able to discharge its legal duties under CRA Regulation.
70. For the purposes of this assessment, ESMA expects at least the third-country authority to have 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.
71. carry out on-site inspections In addition, as set out in Article 24 of CRAR, the third-country authority has to be able to take the following measures following an infringement by a CRA under r:
- (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; and
  - (e) to issue public notices.

### 2.7.3 Sanctions

72. Article 36 of CRAR 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.
73. 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.

**Annex III: Requirements in CRAR which are met by one or more third-country CRAs in a way which is different from how an endorsing CRA of the same group meets them**

Article	Description of requirement
Article 7(4)	Analyst Rotation
Article 8(3) and associated RTS and guidance	Requirements to review and validation of methodologies
Article 8(5)	Annual review of credit ratings
Article 8(6)	Consultation on changes to rating methodology and informing affected entities
Article 8(7)	Reporting errors in rating methodology
Article 10(2a)	Protection of confidential and inside information.
Article 10(4)	Unsolicited ratings and related disclosures
Article 10(5)	Disclosure of participation of a rated entity in a non-solicited rating using a colour code
Article 11(3)	Reporting of the proportion of issued unsolicited credit ratings
Article 12	Transparency report
Paragraph 2 of Section A of Annex I	Existence of independent non-executive directors on the board
Paragraph 2 of Section B of Annex I	Disclosure of clients making up at least 5% of total fees
Paragraph 3C of Section B of Annex I	Fees charged to be cost-based and non-discriminatory
Paragraph 3(ca) of Section B of Annex I	Prohibition to rate entity when the same shareholder 10% in the CRA and the entity
Paragraph 8 of Section B of Annex I	Record keeping 5 years and 3 years after deregistration
Paragraph 3 of Section C of Annex I	Protection of confidential information.
Paragraphs 6-7 of Section C of Annex I	Look back review when an analyst leaves a CRA
Paragraph 8 of Section C of Annex I	See Article 7(4)
Paragraph 1 of Subsection I of Section D of Annex I	Presentation and disclosure of credit ratings

Paragraph 3 of Subsection I of Section D of Annex I	Pre-publication notice/Issuer notification (24-hour rule)
Paragraph 6 of Subsection I of Section D of Annex I	Disclosure and reporting of preliminary ratings and initial reviews
Subsection II of Section D of Annex I	Disclosure applicable to a rating of a structured finance instrument
Paragraph 2 of subsection II of Section E of Annex I	See Article 11(3)
Subsection III of Section E of Annex I	See Article 12