EUROPEAN COMMISSION

Brussels, 2.6.2010
SEC(2010) 678

**COMMISSION STAFF WORKING DOCUMENT**

# ***IMPACT ASSESSMENT***

***Accompanying document to the***

Proposal for a

**REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**amending Regulation (EC) No 1060/2009 on credit rating agencies**

{COM(2010) 289 final}
{SEC(2010) 679}

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## 1. INTRODUCTION

The Regulation on credit rating agencies (Regulation (EC) N° 1060/2009) (hereafter "the CRA Regulation") has been published in the Official Journal on 17th November 2009[1]. It came as one of the first key regulatory responses of the EU to deal with the problems in the financial markets during the financial crisis that started in 2007. During the negotiation of the CRA Regulation, for which political agreement was reached on 23rd April 2009, some Member States and the European Parliament had requested a centralised direct supervision on CRAs at European level in the short term. As a result the CRA Regulation[2] provides that by 7th December 2010 the Commission shall assess the supervisory aspects of the Regulation, in particular the cooperation of the competent authorities, the legal status of CESR and supervisory practices, in order to present proposals for a review of the Regulation.

The Commission Communication of 27th May 2009, "European financial supervision"[3], proposed changes to the architecture of European financial supervision in order to remedy shortcomings in the area of financial supervision revealed by the financial crisis of 2008-2009. Specifically, it proposed the creation of two new bodies:

• a European Systemic Risk Council (ESRC) which should monitor and assess risks to the stability of the financial system as a whole ("macro-prudential supervision"), and should provide early warning of systemic risks that may be building up and, where necessary, recommendations for action to deal with these risks;

• a European System of Financial Supervisors (ESFS) for the supervision of individual financial institutions ("micro-prudential supervision"), consisting of a network of national financial supervisors working in tandem with new European Supervisory Authorities (European Supervisory Authorities), created by the transformation of the existing Committees for the banking, securities and insurance and occupational pensions sectors[4].

The Conclusions of the European Council of 18-19th June 2009 supported the creation of an ESRC (renamed European Systemic Risk Board, henceforth ESRB) and an ESFS, consisting of three new European Supervisory Authorities. Moreover, the conclusions emphasised that the European Supervisory Authorities should have direct supervisory powers for credit rating agencies.

The Commission proposal for a Regulation establishing a European Securities and Markets Authority[5] (ESMA) establishes[6] that ESMA shall execute any exclusive supervisory powers over entities with Community-wide reach or economic activities with Community-wide reach entrusted to it in the legislation referred to in its scope of action. It mentions that "for that purpose, the Authority shall have appropriate powers of investigation and enforcement as specified in the relevant legislation, as well as the possibility of charging fees." The "general

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1 OJ L 302 of 17.11.2009, p.1.
2 Article 39(2) and Recital 51.
3 COM(2009) 252 final
4 Widely known as the "Lamfalussy level 3 committees": the Committee of European Banking Supervisors, the Committee of European Securities Regulators and the Committee of European Insurance and Occupational Pensions Supervisors.
5 COM(2009) 503 of 23.9.2009
6 Article 6(3)

approach" reached in the ECOFIN Council on 2nd December on the proposal for a Regulation establishing ESMA has confirmed the abovementioned European Council conclusions, although restricting its scope only to CRAs. The European Parliament is currently working on its opinion; in line with the Framework Agreement between the two institutions, the Commission reserves its position pending the delivery of that opinion.

The forthcoming amendment of the Regulation on credit rating agencies will deal with the modification of the supervisory structure in order to adjust it to the new European supervisory architecture.

**Available impact assessments**

The Communication from the Commission on European Financial Supervision[7] was accompanied by an impact assessment analysing the main policy options for establishing the European System of Financial Supervisors (ESFS), composed of national supervisors and three new European Supervisory Authorities for the banking, securities and insurance and occupational pensions sectors. Furthermore, a second impact assessment has been executed to examine the impact of the proposals related to the new European financial supervisory structure adopted by the Commission in September 2009. In that document the Commission included an initial analysis of the impacts triggered by entrusting exclusive competences in direct supervision of entities with EU-wide reach to the European Securities Market Agency[8]. That impact assessment included the following observations on this matter:

Absence of legal arrangements allowing for EU-wide supervision of specific institutions, would in the case of credit rating agencies more than in most other areas of financial services lead to the risks of competitive distortions in the Internal Market and – prospectively – to regulatory arbitrage[9].

It was found that *the supervision of such entities involves a clear Community dimension. For example, (…) credit rating agencies based in one country can issue ratings which affect a large number of countries. Consequently, it is not optimal that a single national authority should be entrusted with the task of supervising them. From this perspective, granting this power to a European body could be more effective and coherent than sharing this competence with national supervisors. It would also be more efficient as it would concentrate the costs of supervision in only one authority avoiding any overlaps*[10]. As a consequence, the possibility of granting full supervisory powers only for entities with a Community-wide reach was identified as the most suitable solution to exercise the public oversight of such entities.

Whilst the impact assessment identified the possibility of granting full supervisory powers for entities with a Community-wide reach as the preferred policy option, it stopped short of

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7 Communication from the Commission - European financial supervision, COM/2009/0252 final, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0252:FIN:EN:PDF

8 Commission Staff Working Document, accompanying document to the (…) Proposal for a Regulation of the European Parliament and of the Council establishing a European Securities and Markets Authority, 23 September 2009, available at: http://ec.europa.eu/internal_market/finances/docs/committees/supervision/20090923/20090923_impact_en.pdf

9 Idem, p. 5.

10 Idem, p. 26.

setting out the pros and cons of granting full supervisory powers to the Authorities for any particular category of institution (e.g. CRAs)[11].

However, the impact assessment did take into account the needs of this integrated EU-level oversight when identifying the optimal solutions in terms of organisation, structure and financing of the Authorities charged with such responsibility. In particular, the estimated budget of the ESMA in the first year of operation (2011) already included appropriations for "Supervision of entities with a Community-wide reach"[12], referring to the possibility of direct supervision of CRAs by that Authority.

This document, building on the existing impact assessments, is the impact assessment accompanying the initiative for the amendment of the Regulation on CRAs; it does not pre-judge the final form of any decision to be taken by the European Commission.

## 2. PROCEDURE

### 2.1. Consultation

Ahead of tabling the proposal to establish a regulatory framework for CRAs, the European Commission launched a public consultation starting on 31st July and lasting till the beginning of September 2008 which sought comments on two draft legislative solutions. DG MARKT services presented two different options on both the authorisation procedure and the supervisory structure. One of the options envisaged the establishment of a Community Agency (CESR or a new Agency) financed from the EU budget and with its own legal personality. Though, notably in the context of the financial crisis the creation of an agency became an appealing idea (CRAs industry was in general in favour of an agency approach), this option was rejected at the time of the consultation as it was considered not proportionate to create a Community agency to deal only with CRAs. On the contrary, this option emerged as a reasonable and politically necessary solution within the framework of the De Larosière discussions.

The Commission services received 82 contributions: 13 from credit rating agencies, 52 from organizations of stakeholders (banks, associations, investment funds, savings banks etc) and 17 from securities regulators and ministries of finance of Member States. The non-confidential contributions can be consulted in the Commission website[13].

### 2.2. Discussions with Member States and CESR

The European Commission has consulted the Member States in the European Securities Committee[14]. The national regulators in the framework of CESR have been also informed of the modifications to be introduced in several meetings[15]. During these consultations Member States and regulators have supported the idea to entrust ESMA with exclusive supervisory and enforcement powers over CRAs.

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11 Idem, p. 14.
12 Idem, Annex 1, p. 6.
13 See http://ec.europa.eu/internal_market/securities/agencies/index_en.htm
14 ESC meetings: 16.12.2009
15 CESR plenary meetings: 16.10.2009, 11.12.2009 and 10.02.2010.

## 2.3. Steering Group

The Steering Group for this Impact Assessment was formed by representatives of a number of services of the European Commission, namely the Directorate General Internal Market and Services, the Directorate General Human Resources and Security, the Directorate General Budget, the Directorate General Competition, the Directorate General Economic and Financial Affairs, the Directorate General Employment, Social Affairs and Equal Opportunities, the Directorate General Health and Consumers, the Directorate General Enterprise, the Directorate General of Justice, Freedom and Security, the Directorate General Trade, the Legal Service and the Secretariat General. This Group met three times, on 15 December 2009, on 8 and 25 January 2010. The contributions of the members of the Steering Group have been taken into account in the content and shape of this impact assessment.[16]

## 2.4. Impact Assessment Board

DG MARKT services met the Impact Assessment Board on 24 February 2010. The Board analysed this Impact Assessment and delivered its opinion on 26 February 2010. During this meeting the members of the Board provided DG Markt services with comments to improve the content of the Impact Assessment that led to some modifications of this final draft. These are the most relevant ones:

– an outline of specificities of the activity of CRAs in terms of "Community-wide reach";

– more extended analysis of the subsidiarity, proportionality and cost-effectiveness of centralised supervision by ESMA;

– expanded justification for the proposed sanctioning regime;

– clarification of the extent of consultation carried out.

# 3. PROBLEM DEFINITION

Credit rating agencies issue creditworthiness opinions that help overcome the information asymmetry between those issuing debt instruments and those investing in these instruments. CRAs have a major impact on the financial markets, with their rating actions closely followed by investors, issuers, borrowers and governments. It is essential, therefore, that they consistently provide top-quality, independent, and objective credit ratings.

**A brief look at the CRA industry**

The credit rating market is oligopolistic and effectively dominated by three large entities operating globally: Standard & Poor's, Moody's Investors Service and Fitch Ratings. The three CRAs have a combined market share in excess of 90 % globally[17]. In Europe a number

[16] In accordance with the rules for the elaboration of impact assessments the minutes of the last meeting of the steering group have been submitted to the Impact Assessment Board together with this impact assessment.

[17] See Point 1.3 of the Commission Staff Working Document accompanying the Proposal for a Regulation of the European Parliament and of the Council on Credit Rating Agencies – Impact Assessment, 12 November 2008, available at: http://ec.europa.eu/internal_market/securities/docs/agencies/impact_assesment_en.pdf.

of distinctly smaller CRAs operate with a clear focus on specific industry sectors (e.g. insurance industry) or financial market segments (e.g. municipal bonds), thus responding to specialised market needs. Altogether, around 50 CRAs are established in the EU[18].

The objective of the CRA Regulation is the establishment and proper functioning of the internal market in financial services, by laying down conditions for the issuance of credit ratings to recover markets' confidence and increase investor protection. The Regulation introduces a registration procedure for CRAs to ensure that their credit ratings can be used by credit institutions, investment firms, insurance and assurance undertakings, collective investment schemes and pension funds within the Community. Thus, CRAs will have to comply with rigorous rules to make sure that: (i) the risks of conflicts of interest affecting ratings are effectively addressed (ii) CRAs remain vigilant on the quality of the rating methodology and the ratings and (iii) CRAs act in a transparent manner.

An essential element of the CRA Regulation is the introduction of an external oversight regime whereby European regulators will supervise the issuance of credit ratings by CRAs[19]. The CRA Regulation has introduced a system of supervision based on colleges of competent authorities of the Member States, which gives the possibility to all concerned competent authorities to participate in the process of registration and supervision of a credit rating agency or a group of CRAs; although the final decision is always taken by the competent authority of the home Member States.

The supervisory framework of CRAs was one of the most difficult subjects in the negotiations between the Council and the Parliament, successfully concluded on 23rd April 2009. At the same time, the absence of regulation in the field of CRAs and the general outcry with respect to their role in the financial crisis put a lot of pressure on the EU institutions and Member States in adopting rapidly mandatory and enforceable substantial rules in this field. The De Larosière report of March 2009 followed by the Commission Communication of 27th May 2009 opened at political level the possibility to create a Community Agency which would deal with issues beyond CRAs. The compromise solution on the CRAs Regulation envisaged already the need to review the supervisory provisions of the Regulation taking into account the new developments at political level. As explained above it was not possible to hold up the negotiation on the CRAs Regulation pending the supervisory reform, due to our commitments at the G-20 level and the need to restore confidence in the markets in a period of crisis. The resulting compromise – creating an admittedly complex and heavy structure – was the best deal achievable at the time in its context, a context that was quickly overtaken however.

The Commission proposal for a new supervisory structure in Europe establishing three European Supervisory Authorities has changed the picture. The Council agreed in December 2009 to entrust in principle the new ESMA with direct supervisory powers on CRAs[20].

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18 See detailed list in Annex I.

19 The CRA Regulation replaced a previous policy approach in this respect, under which the CRAs were expected to incorporate all the provisions of the IOSCO Code into their codes of conduct. However, that self-regulatory approach did not deliver on expectations as it had been followed on a voluntary basis by CRAs, which were often taking advantage of the "comply or explain" principle. Under that approach an in-depth, independent examination of the actual compliance was not possible. The start of the financial crisis shed light on significant weaknesses of the CRAs in their internal organisation, transparency and managing conflicts and thus prompted a new, more exacting EU policy in this matter.

20 See Art. 6 (3) of the Presidency compromise on the ESMA Regulation (general approach) agreed by ECOFIN on 2 December 2009 http://register.consilium.europa.eu/pdf/en/09/st16/st16751-re01.en09.pdf

However, it is not merely political sentiment that goes in favour of considering more centralised EU oversight of CRAs. There are strong factual indications that such approach would better correspond to the business specificities of this sector.

**Specificities of the CRA industry from a regulatory perspective**

– 1. In the case of the largest CRAs, it is difficult to establish **where a specific credit rating has been produced or issued** (this information is relevant when establishing territorial competence of a regulator). Analytical teams are frequently multinational and responsibilities for individual ratings are allocated on the basis of specialisation and sector knowledge not less frequently than on the basis of geographical considerations (e.g. because of his/her specialisation in the field an analyst working in a German CRA prepares, in co-operation with a French colleague working for a French CRA belonging to the same group, a rating on an French insurance company). As a result, the national regulators overseeing the credit rating activity within their jurisdictions are likely to find themselves in situations of competing supervisory interests. Moreover, for larger CRAs the flexibility in the allocation of credit rating activity opens the way to optimise their regulatory burden.

2. It is **nearly impossible to delimit with certainty the territorial impact of a credit rating in use** (this information is important for a supervisor to determine whether the activity of a specific CRA is relevant for the financial market under its surveillance). Ratings may be used for regulatory purposes (mainly by banks, insurance companies and investment firms), but they are also frequently consulted by individuals and entities not subject to regulatory requirements in this respect. Access to and the use of credit ratings is not restricted by geographical limits (they are normally disclosed publicly free of charge or distributed by subscription). The language barriers are less relevant (not only because of predominant use of English, as the *lingua franca* in professional financial services but above all due to the use of rating symbology (e.g. AAA for top quality debt) which can be easily processed and viewed as an easy-to-apply proxy for quality of financial instruments.

The activity of CRAs is markedly different from the one of banks or insurance companies. It does not have such a strong territorial attachment (in terms of physical presence or capital engagement) and the impacts over a particular jurisdiction of events concerning a particular CRA can be much less discernible. Consequently, and though the supervisory framework currently prescribed by the CRA Regulation has not been put in place yet, it is already possible to identify certain shortcomings. Those deficiencies and their main consequences for CRAs and supervisors are:

### 3.1. Multiplicity of supervisors involved and risks of conflicts over competences

The complex supervisory framework, involving (i) mandatory close co-operation between competent authorities and (ii) actual use of supervisory and enforcement powers by only some of them, has been structured in that way to ensure that interests of all relevant supervisors were well represented and taken into account by those taking the final decision. At the same time it had to take into account the specific nature of the rating activity. Consequently, the division lines between geographical competences of supervisors were not set too firmly,

creating room for potential intra-EU disputes[21]. Importantly, this policy choice implies that the CRAs would be faced with the duty to interact with several competent authorities in the same field. The main problem arising from this situation is the risk of conflicts over competences, which may lead to potential gaps (ineffective supervision); overlaps (inefficient supervision); or arbitrage/unlevel playing field.

**Table 1 Expected size of supervisory colleges[22]**

| CRA (group) name[23] | No. of subsidiaries in the EU | No. of regulators with home competent authority status | No. of regulators in college (including home competent authorities) |
|---|---|---|---|
| Moody's | 7 | 7 | 14 |
| Standard and Poor's | 6 | 6 | 13 |
| Fitch | 6 | 6 | 9 |
| Coface | 4 | 4 | 8 |
| DBRS | 1 | 1 | 4 |
| Euler Hermes Rating | 1 | 1 | 2 |
| Credit Reform Rating | 1 | 1 | 2 |
| Capp&Capp | 1 | 1 | 2 |
| European Rating Agency | 1 | 1 | 2 |
| AM Best | 1 | 1 | 2 |

Source: Commission and CESR, based on inputs from its members – December 2009

The above table offers an early prediction of size of the supervisory colleges, involving more than one member. It indicates that not only the largest CRAs may expect participation of competent authorities from different Member States in their supervision. A number of smaller CRAs are also likely to attract attention of host supervisors from Member States other than that of their establishment in the EU.

### 3.2. Risk of divergent and inconsistent application of the CRA Regulation in individual acts by competent authorities in the Member States

Irrespective of several elements triggering close co-operation between individual supervisors (e.g. work in colleges), the existing model for CRA supervision is ultimately based on the exercise of supervisory and enforcement powers by individual regulators in the Member States. It is possible for the competent authority of the home Member State to override the

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21 Further to Article 25 of the CRA Regulation, a supervisor other than the home competent authority is – after having notified the facilitator and having consulted the relevant college – entitled to take individual decisions on issuing public notices and referring matters for criminal prosecution, take measures compelling a CRA to comply with the CRA regulation within its territory and impose the suspension of the use of credit ratings for regulatory purposes within its jurisdiction. Such measures, albeit subject to prior consultation among supervisors, may be eventually taken individually and against the views of the home competent authority or the college.

22 These figures have been prepared with the assumption that group structures of the existing CRAs will not be changed and that all of the subsidiaries will seek registration as mandated by the CRA Regulation. Additionally, they reflect early declarations of interest to participate in the specific supervisory colleges, as expressed tentatively by CESR members.

23 A list of CRAs currently established in the EU, indicating the place of establishment and in case of CRA groups, the place of establishment of all subsidiaries, is provided in Annex I.

views of its partners participating in the college. It is also possible for a competent authority of the host Member State to take an individual action, not approved by the relevant college. This can lead to divergent and inconsistent application of the CRA Regulation in individual acts by competent authorities in the Member States.

### 3.3. Burdensome and time-consuming administrative process

Dealing with several supervisory authorities across the EU would involve substantially higher compliance costs for the rating agencies. On the supervisors' side, the demanding co-ordination and consultation rules, which are a corollary of having all interested authorities engaged in the supervisory and enforcement process, are expected to weigh heavily on the ability of the EU supervisory framework to produce timely and efficient outcomes[24].

### 3.4. Risk of misaligned incentives: can national supervisors cope with the pan European dimension of CRAs?

Competent authorities in the Member States may perceive the dimension of CRA supervision mainly from a national perspective missing a full picture of the global nature and impact of a CRA's activity. Especially in situations where the main impact of a CRA lies outside the Member State where it is registered, there is the risk that the home competent authority does not allocate sufficient resources for the supervision of this CRA. It could create conflicts that the competent home supervisor, which is used to being responsible for its home financial market and accountable to its national political institutions, has to take the main responsibility for CRA activities with pan- European reach affecting primarily financial markets outside its home jurisdiction. This inherent conflict may necessitate time consuming and costly coordination/enforcement actions by ESMA.

It is also worth noting that while the activity of CRAs has an impact throughout the EU, only the home competent authority, i.e. the competent authority of the Member State in which the CRA is established, will be able to charge registration and supervisory fees. This may have the consequence that host competent authorities are less committed in participating and contributing to the supervisory work. Section 7 analyses the different options that may be considered in order to address the above mentioned problems and concludes with the choice of the preferred option. Since some of the options considered (namely Option 3a and 3b) envisage entrusting centralised oversight of credit rating agencies operating in the EU to ESMA, it will be also pertinent to examine how to best allocate certain powers (more specifically, the power to recommend sanctions to the Commission), if ultimate supervisory responsibility was transferred to ESMA so as to ensure efficient supervision. Section 8 provides the relevant analysis and comparison of options regarding the allocation of sanctioning powers.

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[24] For example, in order to take a supervisory measure (like suspending the use of a rating), the competent authority of the home Member State may be expected to notify the college and the college facilitator, then consult the college on a proposed measure, and if no agreement can be reached consult the CESR, and the college again. Only after those iterations are completed, the competent authority may take a decision.

## 4. SUBSIDIARITY AND PROPORTIONALITY

The problems identified in Section 3 cannot be effectively addressed at Member States level as they stem from existing EU legislation and can only be addressed through changes in EU legislation in accordance with the subsidiarity and proportionality principles:

– **Subsidiarity.** CRAs business is different from other financial services sectors, as it has a global nature due to the mobility of the rating service and the cross-border impact of credit ratings. The current supervisory model was introduced as a crucial element of the EU compromise solution to address the weaknesses in the CRA sector highlighted by the financial crisis. Accordingly, Community action would be required to make changes to the current framework or to provide for a new system that would respond better to the objective of a stable and single EU financial market for financial services. Whichever solution is eventually chosen, the traditional division between the competent authority of the home Member State and other competent authorities appears inadequate as a long-term answer to the issue of CRAs oversight given that:

  – credit ratings issued by the largest CRAs are already issued "globally", usually more than one CRA participates in the issuance of a credit rating;

  – big CRAs are organised not as independent national companies but as European and global groups, with a broad range of interrelationships between the different subsidiaries and branches of a group;

  – the rating business can take place not only in the EU, but in various third country jurisdictions, being necessary to facilitate convergence and coordination also at international scale;

  – ratings of smaller CRAs – which as a result of uniform EU registration standards are expected to gain reputation and be used beyond their traditional local markets - will not be any more circumscribed to a national territory and affect more than one jurisdiction within the European Union.

– Finally, the on-going efforts in the European Parliament and in the Council to adopt a Regulation establishing a European Securities and Markets Authority (ESMA) are in essence about putting in place a new post-crisis model of EU financial supervision. As pointed out earlier (see Sections 1 and 3), co-legislators have considered that as part of the debate on this new framework, it may be desirable to reflect on the registration and oversight of credit rating agencies and on the merits of centralising those functions at the EU level. The solutions discussed in this document aim to produce a response that will be both effective and efficient, and will seek to respect the principle of subsidiarity.

– **Proportionality.** In this impact assessment, the European Commission takes into account the principle of proportionality in the identification and analysis of options. The preferred policy options are to be compatible with the proportionality principle, taking into account the right balance of public interests at stake and the cost-efficiency of the measure. In this respect the proportionality of the options identified will be analysed in the context of smaller national credit rating agencies.

## 5. OBJECTIVES

CRAs have a very significant impact on the operation of the financial markets, as their credit ratings are used by investors, borrowers, issuers and governments as part of making informed investment and financing decisions. It is therefore essential to ensure that the regulatory and supervisory framework in which CRAs operate is sufficiently robust and effective to satisfy the general objectives[25] of:

Contributing to the stability of financial markets,
Enhancing investor protection,
Facilitating a sustainable development of fair and transparent financial markets.

Those general objectives, which are the ones of the CRA Regulation, translate into more sector-focused objectives reflecting the focus of the current proposals. In this regard the following objectives can be identified:

Securing effective supervision of CRAs in the EU,
Streamlining the supervisory architecture for the CRA industry,
Ensuring legal certainty for CRAs and market participants.

Having those overall objectives in mind, it should be aimed that any proposed changes in the organisation and functioning of the supervision of CRAs ensure the fulfilment of the following, operational-level objectives:

### 5.1. Ensuring a single point of contact and clear competences

The principle of a single point of contact (or "one stop shop") should be reinforced. Risks of conflicts over competences must be effectively addressed.

The territorial competences of supervisory authorities need to be structured in a way ensuring that CRAs registered in the EU are not expected to interact with more than one supervisory authority in matters of compliance with the CRA Regulation. Moreover, risks of conflicts of competences (both when two or more authorities see themselves as competent to act, and when none of them considers itself competent to take action) should be eliminated as much as possible. This objective deals with avoiding conflicts of competences. Such conflicts should not be confused with conflicts of views on supervisory issues, which may arise between regulators even in an environment of clearly delimited and not overlapping territorial competences. The need to deal in a timely and consistent manner with the latter type of conflicts is addressed by the objectives 5.2, 5.3 and 5.4.

### 5.2. Ensure a consistent application

Rules for CRAs are to be applied in a consistent manner across the EU. The EU supervisory framework should be structured in a way ensuring consistent application of the CRA Regulation (both substantive and procedural provisions) across the Member States. A consistent application is a necessary prerequisite for legal certainty.

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[25] Commission Staff Working Document accompanying the Proposal for a Regulation of the European Parliament and of the Council on Credit Rating Agencies, SEC(2008)2745 of 12.11.2008.

### 5.3. Ensure efficiency gains

The CRAs business is a global one: it is difficult to establish where a specific credit rating has been produced or issued; it is nearly impossible to delimit with certainty the territorial impact of a credit rating in use. Moreover, when dealing with a group of CRAs, there may be conflicts of interest and deficiencies in the way ratings are elaborated in the group itself that cannot be assessed at the level of each individual subsidiary. Therefore, it is necessary to develop a holistic approach going beyond the subsidiary level, to set up a single central authority at the EU entrusted with the registration and supervision of CRAs to ensure efficiency gains.

This new approach would be both beneficial with regard to the assessment of the CRAs business and thus raise efficiency of the supervisory process and it will also imply significant gains in terms of reducing administrative burden for the supervised CRAs. Lengthy decision-making procedures among supervisors should be eliminated. The use of supervisory resources allocated to supervision of CRAs should be optimised. Availability of adequate supervisory skills, ease of interaction with CRAs subject to the CRA Regulation, knowledge of local conditions should all be secured (e.g. through the delegation of tasks to national competent authorities). It should be aimed that the option finally pursued brings benefits to the users of ratings and does not involve disproportionate budgetary charges.

### 5.4. Ensure better alignment of incentives for the supervisory authorities to cope with the pan European activity of supervised entities

The perspective, oversight capacity and reach of the supervisory authority should match the pan European dimension of the activity of the largest CRAs whose ratings have impacts across the Member States. The supervisory authority should be committed to ensure the stability and integrity of all European financial markets that may be affected by the rating activity of such a CRA.

Case law of the European Court of Justice identifies limits to delegation of powers to regulatory agencies (like ESMA)

According to the "Meroni"[26] case law established by the ECJ, agencies/authorities may not be delegated the power to take decisions which require difficult choices in reconciling various objectives laid down in the Treaty amounting to the execution of actual economic policy. On the other hand, clearly defined executive powers can be delegated to an agency including powers, that involve the need to interpret Community law provisions to determine their application and which leave the authority a certain margin of appreciation in applying these rules.

## 6. POLICY OPTIONS

In relation to problems 3.1 through 3.4, the following broad options have been considered prior to the policy choice made by the Commission when tabling this proposal:

[26] Case 9/56 Meroni [1958] ECR 133

### 6.1. Option 1 - Status quo (current CRA Regulation) [27]

This option would consist in maintaining the key elements of the current supervisory set-up, agreed in the course of the negotiation of the CRA Regulation. At present, the Regulation provides for a college-type of supervision, which gives the possibility to all concerned competent authorities to participate in the process of registration and supervision of a credit rating agency or a group of CRAs. In practice, it means that most supervisory decisions and actions are discussed and agreed within the college of competent authorities. On that basis, the competent authority of the home Member State (i.e. where the CRA has its registered office) implements those decisions in administrative terms. In certain cases, when agreement on the action to be taken cannot be reached within the college, the opinion of the CESR is sought. Should lack of agreement among competent authorities persist, the competent authority of the home Member State has the final say on the decision (except for registering CRAs). In some limited situations, the "host" competent authorities are also entitled to take individual action with regard to CRAs. The CESR produces guidance on application of the rules and operates the so-called central repository, where historical performance data of CRAs are collected and made available to the public.

### 6.2. Option 2 - College structure and ESMA

6.3. This option reflects the situation that the ESMA Regulation is adopted as proposed by the Commission on 23rd September 2009 and that the supervisory framework as provided by the current CRA Regulation is maintained.

The competent authorities would retain their competence and responsibility to register CRAs, to use administrative powers, measures and sanctions and to exercise day-to-day supervision and enforce the CRA Regulation.

The competent authorities of the Member States would continue to work in colleges. ESMA would have the right to participate in these colleges (Article 12 of the ESMA proposal). In areas where the CRA Regulation requires cooperation, coordination or joint decision making (e.g. regarding registration of a CRA or supervisory measures towards a CRA) ESMA could be called to mediate and finally settle a conflict between competent authorities in a college.[28]

ESMA would also have the power to monitor the correct application of the CRA Regulation by competent authorities, issue recommendations towards the competent authorities in case of alleged incorrect application, and could under specific circumstance address decisions directly to CRAs.[29]

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[27] We are aware that this option which reflects the supervisory framework under the current CRA Regulation would not be realistic if ESMA enters into force as envisaged by beginning of 2011. In the latter case, ESMA will have additional powers which would also impact on its role regarding the registration and supervision of CRAs. Nonetheless, we think it is important to refer to the current CRA Regulation as baseline scenario as the content of the future ESMA Regulation and in particular how the current CRA Regulation would be adapted to it are not (yet) fully clear. We describe under option 2 a possible scenario how the current CRA Regulation could function under the (future) ESMA framework.

[28] The CRA Regulation would have to be slightly amended in order to integrate the settlement procedure foreseen in Art 11 ESMA proposal.

[29] See Article 9 (6) but also Article 11 (4) and 10 (3) of the ESMA proposal.

In very limited emergency situations the ESMA could take action towards competent authorities and CRAs (Article 10 ESMA Regulation).

It could also be foreseen that ESMA propose technical standards in certain areas to be specified in the CRA Regulation.

### 6.4. Option 3 - ESMA to assume direct oversight of groups of CRAs or all EU-based CRAs

Under this option, the CRA Regulation would be revised in order to introduce centralised oversight of credit rating agencies operating in the EU. The ESMA would assume general competence in matters relating to the registration and on-going supervision of registered credit rating agencies as well as matters related to ratings issued by rating agencies established in third countries that operate in the EU under the certification or endorsement regimes. Those responsibilities would involve the use of administrative measures and recommendations to the Commission on the use of sanctions.

Within this broad option we may distinguish two alternative scenarios. Under either option, some specific supervisory powers related to the use of credit ratings would remain in the remit of national competent authorities.

#### *6.4.1. Option 3a - CRAs (groups of CRAs) with legal presence in more than one Member State*

ESMA's authority would be limited to the supervision of CRAs (groups of CRAs) with legal presence in more than one Member State. The registration, supervisory and enforcement issues of other, typically nationally operating CRAs would fall under the responsibility of the relevant competent authority in its Member State. It could be considered that, with such division of competences between the European and Member States' level in place, the supervisory framework would be more adjusted to the different activity profiles of CRAs, some of which are strong, global players and some are entities operating locally only.

#### *6.4.2. Option 3b - all EU-based CRAs*

Under this sub-Option, the ESMA would be the sole supervisor of all EU-based CRAs.

## 7. ANALYSING AND COMPARING THE OPTIONS

### 7.1. Single point of contact and clear competences

Maintaining the *status quo* (Option 1) implies that credit rating agencies may be approached on compliance issues not only by the competent authority of the home Member State, but also by other competent authorities and CESR.

**CRA-to-competent authority relationships**

The scheme below aims to demonstrate the complexity of interactions involved in the case of supervision of a group of CRAs, as currently provided for by the CRA Regulation. As may be observed, as much as 5 different types of interactions may be involved in the case of a single CRA operating in a group structure in the EU. These are:

- **interaction with the competent authority of the home Member State** – normally this is the most intensive relationship, as the home competent authority is the one entitled to formally take the registration decision, and the one that normally has the last word on on-going supervisory actions and decisions with regard to the supervised entity.

**- interaction with the facilitator** – may arise at the moment of processing the registration file of a group of CRAs, as well as in other cases, should the college of supervisors decide so.

- **interaction with CESR** – is most visible at the moment of registration, when submission of a complete registration file to this body enables the registration process.

- **interaction with host competent authorities members of a relevant college** – those authorities may have a supervisory interest in a specific CRA, which operates a branch on their territory or the ratings of which are widely used or likely to have a significant impact within their jurisdiction. While no qualified decision-making power is envisaged for them under the Regulation, their participation in the college and material influence on its decisions may push CRAs to discuss with them more critical supervisory issues.

- **interaction with host competent authorities outside the college** – under specific circumstances the CRA Regulation (cf. Article 25) allows any competent authority to take supervisory decisions (e.g. to suspend the use of ratings within its jurisdiction, or to compel a CRA to act in a specific manner). This exposes CRAs to an additional regulatory risk, which they need to address by – at least – being open to engage in a dialogue with any such competent authority.

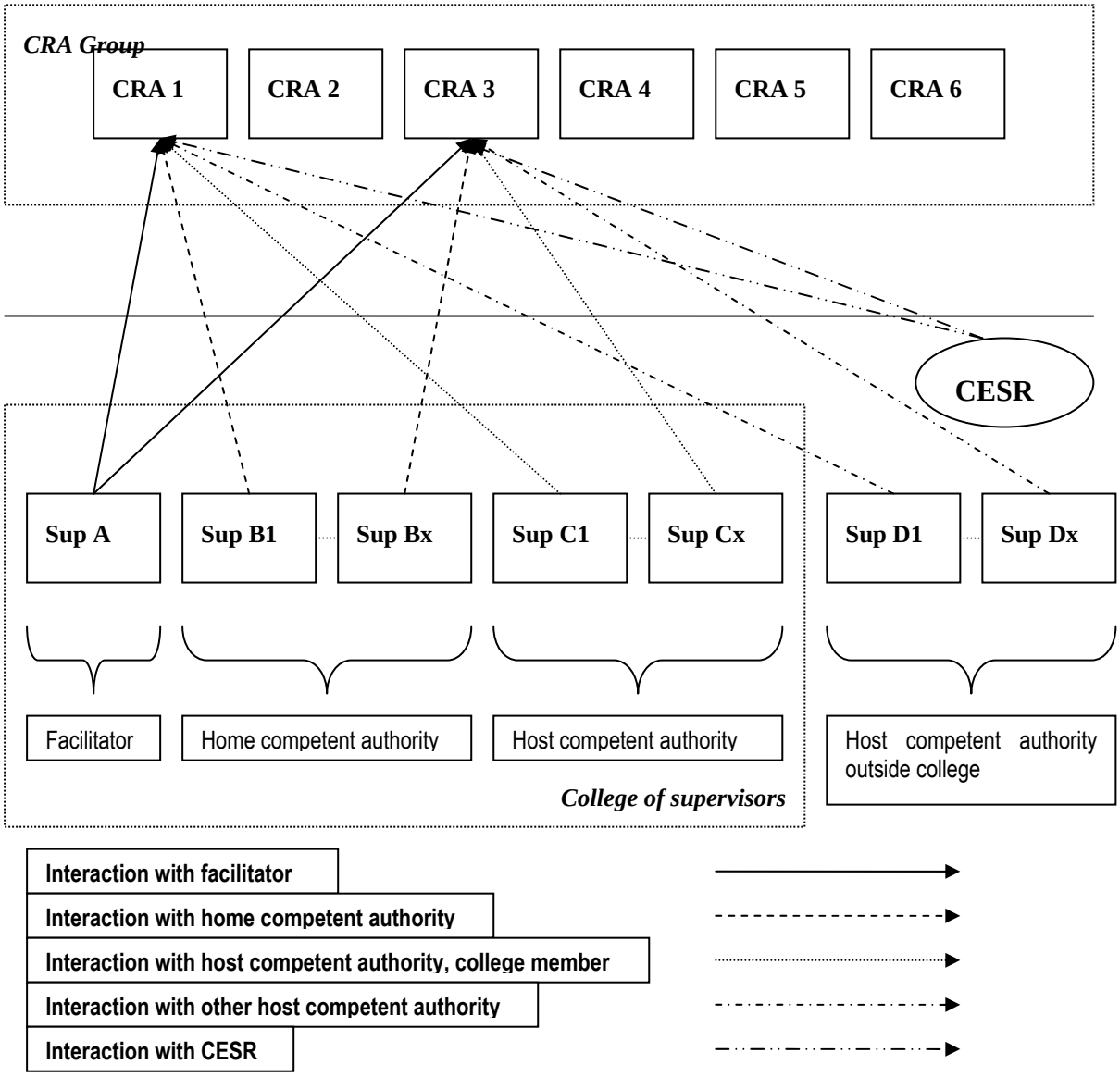


**Figure 1 - Interactions with supervisors – a group of CRAs**

As may be observed on the following scheme, in the case of smaller, regional or national players the matrix of interactions with supervisory authorities is not significantly simpler in relative terms (see Fig. 2). In the scenario presented[30], where in addition to the home Member State competent authority (acting as the facilitator) another authority is in the college, 4 different interactions with supervisory authorities may be expected. In the most simple of the scenarios possible (i.e. a 1-member college), this number could be only reduced to three.

[30] Based on information from CESR, this scenario could apply to at least 4 smaller CRAs.

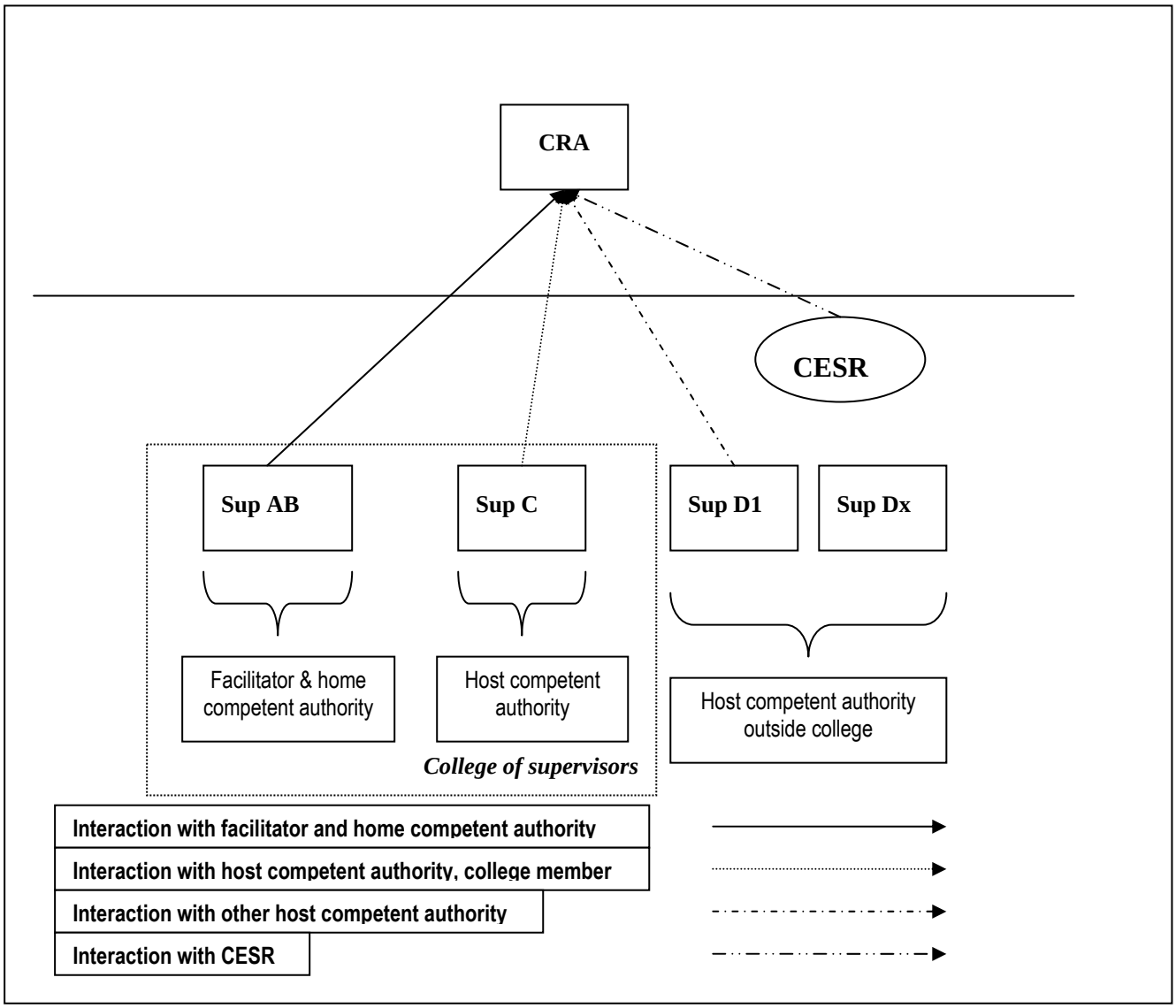


**Figure 2 - Interactions with supervisors – a small CRA**

Those other authorities may formulate expectations regarding a CRA's conduct and they have administrative means to trigger a CRA's compliance with their orders. Certainly, such outcome is suboptimal not only because of increased compliance costs and CRAs' resources engaged (as signalled further), but also because it puts into question the effective and efficient functioning of supervisory arrangements envisaged for this sector.

For the involved authorities, the supervisory framework involves complexity, as it would require national authorities to:

accept that very close co-operation with their fellow supervisors, is necessary even if in legal terms the responsibility and authority to act rests with only one (or few) of them;

recognise the need for greater reliance on the capacity and diligence put in the supervisory process by other supervisors.

In practice, it may be increasingly difficult for national authorities, which as a rule enjoy independence in supervisory matters as a corollary to significant regulatory duties, to satisfy

at all times the above conditions. As a consequence, interdependencies and occasional overlapping competences can easily trigger conflicts leading to highly undesirable fragmentation of EU oversight of the CRAs[31].

Under Option 2 the ESMA is able to monitor the co-operation of competent authorities in colleges and the application of the CRA Regulation by competent authorities. The ESMA would also be in the position to resolve the conflicts of competences that may arise between co-operating supervisors. As ultima ratio it could also step in and take itself a relevant action (e.g. a decision to an individual CRA that was, in breach of the CRA Regulation, refused by a competent authority of the home Member State). While, admittedly, Option 2 would help mitigate certain possible frictions and interferences in relations between competent authorities, it would fail to deliver a single point of contact for CRAs. CRAs and groups of CRAs would also under this option have to interact with competent authorities from different Member States and in addition with ESMA.

Under Option 3a, responsibilities for supervision of CRAs are distributed between the ESMA (groups of CRAs) and national competent authorities (local CRAs). This option would not bring considerable improvements in terms of clarifying competences. Firstly, even smaller CRAs catering to the needs of local financial centres may still have an EU-wide reach and may require the setting up of a college involving competent authorities from other Member States and also ESMA As impacts of the ratings activity of a locally acting CRA on other financial markets cannot be excluded, other Member States would probably claim a right of intervention (similar to the one in Article 25 of the CRA Regulation). Secondly, it is difficult to distinguish local CRAs (to be supervised by the national competent authorities) from other CRAs (to be supervised by ESMA). While the presence in only one Member State is a clear criterion this does not necessarily imply that the activity of this CRA is only locally relevant. Also the location of the rated entities in only one Member State does not imply that these ratings are only of relevance to this local market. Finally, while the fact whether ratings are used exclusively/predominantly by financial firms/other users in the home market may be a relevant criterion, this criterion is difficult to verify (as ratings are published on the internet) and may frequently change over time. A two-tier approach might therefore bring further complication to the supervisory architecture and create conditions for regulatory arbitrage[32]. Moreover, the European Association of Credit Rating Agencies, notably representing small CRAs, has advocated for a central authority to take decisions on registration and supervision and for further integration in the future, i.e. having one single financial services authority.

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[31] For example, Fitch Ratings in its submission to the 2008 consultation explicitly stated: *Fitch is indifferent as to which option is ultimately chosen by the Commission, provided that the result is truly one stop shopping for authorisation of the activities of the entire CRA group members and a requirement for the CRA group to deal principally with only one supervisor. The burden of responding to duplicative but not identical oversight cannot be overstated.*
*Cf. Fitch Ratings response to consultation, 5 September 2008, p.3 available at: http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/credit_agencies/citizens/fitchpdf/_EN_1.0_&a=d*

[32] A group of CRAs could restructure itself and provide all its rating activities from one office, with the effect that it may legally qualify as "local CRA" which would fall outside the scope of supervision by ESMA while actually the activity of this CRA would be very relevant throughout the EU. This risk should not be considered as remote, given the ease of relocating the issuance of ratings from one office to another.

Option 3b direct oversight of all EU-registered CRAs by the ESMA creates a clear principle that only one authority in the EU is entitled to take action in matters of CRA supervision. Risks of disputes over competence are thus avoided.

### 7.2. Consistent application

In the existing model for CRA supervision the supervisory and enforcement authority normally rests with national regulators, located in the home Member State. This model entails a number of safeguards to ensure that common supervisory policies and specific actions are developed and agreed upon. Those safeguards include mandatory work in colleges, as well as prominent co-ordination and advisory roles of the CESR and the facilitator, in case of group supervision. To a certain extent, the prevailing arrangements are expected to mitigate the risk of dissent and uncoordinated actions by individual supervisors. However, they may not offer full assurance that, for example, two subsidiaries of the same CRA group will not be treated in the same situation differently by two different competent authorities in the EU, or that a host competent authority will disregard the prevailing view in the college and take the measures it considers appropriate individually. Such outcome can be detrimental to the level playing field intended by the CRA Regulation. Option 2 offers a more robust mechanism to ensure consistency. ESMA would monitor the supervisory activity of competent authorities and could intervene if a competent authority breaches the CRA Regulation. ESMA could also settle disagreements between competent authorities and, under specific conditions and as ultima ratio, would be empowered to take a decision directly towards a credit rating agency. Still a risk of inconsistent application of the CRA Regulation persists, given that some conflicts between supervisors or cases of inconsistent application of the CRA Regulation may not come to the attention of ESMA (e.g. a supervisor may prefer to downplay the importance of certain problems with consistent application for the sake of securing a good working relationship with a fellow supervisor concerned, especially if the issue may trigger only limited risks for its own market. In addition, ESMA may not have the capacity to participate in all colleges and therefore there is a risk of inconsistent supervisory practices between colleges). It is also important to note that according to Article 11 of the proposal for the ESMA Regulation, ESMA may only settle conflicts if requested by one of the authorities concerned (but not on its own initiative).

Option 3b delivers best results in terms of ensuring consistent application: with only one, European authority responsible for developing a supervisory policy and implementing it, the risks of inconsistent approach in the application of the CRA regime across the EU are very reduced. Option 3a, because of maintaining a two-tier system (EU authority for larger CRAs, national supervisors for smaller players), does not offer similar advantages and may raise level-playing field concerns.

### 7.3. Efficiency gains

*Simplification of the supervisory process*

Under the current supervisory architecture (Option 1), the supervised entities are expected to submit their registration application to CESR and provide it with data inputs regarding their historical performance. They are required to co-operate with and to submit to supervisory and enforcement actions of the competent authority of the home Member State. In the case of organisations operating in a group structure (in legal terms, a group of CRAs, which are registered individually in the Member States of their legal establishment) this involves multiple supervisory relationships concerning substantially the same compliance duties and

arrangements. Additionally, any EU-registered CRA may expect being approached also by competent authorities from the host Member States. The need to operate in this complex supervisory environment will have significant cost implications for the CRAs seeking to establish effective and robust dialogue with the supervisors.

For supervisors themselves, the existing model of CRA supervision involves burdensome and time-consuming processes of co-ordination and joint decision-making.

The registration process of an applicant CRA can take from 2 months (small CRAs) to over 7 months (esp. in more complicated cases – groups of CRAs, CRAs with endorsement etc.). Since all applications would be received and would need to be processed by CESR and colleges of regulators at the same time, it is quite likely that the supervisors would tend to use the maximum time provided for by the regulation.

**Table 2: Registration of a CRA - also applicable to groups of CRAs (joint application)**

| | Action | Max time for action (days) | Min aggregate time (days) | Max aggregate time (days) |
|---|---|---|---|---|
| 1 | CRA submits application to CESR | 0 | 0 | 0 |
| 2 | CESR transfers application to all competent authorities (CAs) | 5 | 2 | 5 |
| 3 | CESR advises on completeness of an application to home CA | 10 | 5 | 10 |
| 4 | Home CA, college decide whether an application is complete | 25 | 10 | 25* |
| 5 | Home CA, college (1) examine application, (2) do all possible to reach consensus on the registration decision, (3) transmit draft decision for CESR advice | 60 | 30 | 85 |
| *5a* | *Additional time granted by facilitator for actions in 5 above, if application complex* | *30* | | *115* |
| 6 | CESR advises on the draft decision | 20 | 35 | 105 (135) |
| 7 | Home CA takes final decision | 15 | 40 | 120 (150) |
| 8 | Notification of the decision to the CRA | 5 | 45 | 125(155) |

**If application incomplete additional time may be given to an applicant to provide missing documents*

*Table conclusion: Registration process may take up to 7,25 months*

Those heavy procedures have been envisaged to safeguard the interests of all Member States in a situation where competent authorities of only some Member States are granted regular supervisory and enforcement powers. At the same time, all Member States are required to designate competent authorities for the purposes of CRA supervision, which should be sufficiently resourced and staffed to perform the ensuing tasks.

The problems of fragmentation of supervisory resources dedicated to CRA supervision and their extensive use for ensuring effective co-operation within the EU supervisory framework cannot be fully resolved under Option 2. Some relief from this burden may be expected at the level of the Member States, as the ESMA would have an enhanced role in facilitating co-operation between them. But the CRAs would still need to ensure that their compliance efforts satisfy (at the same time) the expectations of a number of EU supervisors co-operating in a complex network.

In the case of Option 3a, some significant efficiency gains may be expected as a result of introducing EU-level supervision. However, the supervision of some of the "local" rating agencies may still require the setting up of colleges and therefore the efficiency gains are in this regard less evident than under option 3b).

Under option 3b the supervisory process is significantly faster and less complex as under the baseline scenario. Many of the coordinating steps between CESR, the competent authority of the home Member State, the facilitator and the other members of the colleges will not be necessary any more and we expect that this will considerably accelerate the registration and supervision process. According to the proposal for the ESMA Regulation decisions are in general taken by the board of supervisors composed of the heads of the competent authorities in each Member State (Article 25 of the proposal for the ESMA Regulation). As a general rule decisions are taken by simple majority of its members, therefore there is no risk that decisions are blocked. Decisions will be prepared by ESMA staff with technical expertise in the area of CRAs. In order to streamline the decision making process (e.g. for time sensitive supervisory measures), the proposal for the ESMA Regulation allows the board of supervisors to delegate specific tasks and decisions to internal committees or panels or to its chairperson (Article 26 of the proposal for the ESMA Regulation).

In particular, a CRA panel (composed of CRA experts from national competent authorities) could be established within ESMA to take the registration/supervisory decisions in the field of CRAs (prepared by the ESMA experts). It should also be noted that ESMA will employ a number of national experts seconded from national competent authorities which will ensure the availability and up-to-date knowledge of local conditions. According to the latest estimates submitted by CESR to the Commission in February 2010 50 % of the staff that will be needed for CRA supervision/regulation in ESMA should be seconded national experts.

The decisions taken by ESMA could be appealed to the board of appeal of ESMA and to the European Courts.

*Efficiency with regard to smaller CRAs*

While efficiency gains under option 3 b are evident in the case of (groups of) larger CRAs with a pan European scope it is less evident for smaller CRAs with a local focus. It may cause additional costs for those CRAs to interact with ESMA (due to the geographical distance and possible language barriers[33]) and also on the side of ESMA there may be some cost implications (translation of applications, mission costs, knowledge of local conditions).

[33] However, as the ESMA will qualify as a European regulatory agency the EU language regime will apply so that each CRA may address the ESMA in any of the official languages of the EU. In this respect there will be less burden for the CRAs as under the current CRA Regulation (option 1) which require applications to be sent in addition "in a language customary in the sphere of international finance"- see Article 15 (3) of the CRA Regulation.

However, these costs can to a certain extent be mitigated by providing the option to delegate specific tasks to the competent authorities of Member States. In such cases the ESMA may delegate specific supervisory tasks (e.g. the organisation of an on site inspection, the assessment of an application) to the local competent authority (or mandate a local audit firm with carrying out specific tasks[34]). Delegation of tasks would not affect the responsibility of ESMA which could give instructions to the delegated authority. This option should prevent disproportional costs for local CRAs and make use of the knowledge and experience of national supervisors with respect to local conditions while at the same time it would ensure the consistent application of the CRA Regulation across Europe.

It should also be stressed that differently from the situation in the field of banking or insurance regulation there are no national regulatory specificities with regard to the regulation of credit rating agencies. Before the adoption of the CRA Regulation rating activities were quasi unregulated in the EU and therefore there is no specific national legislation to be applied in the supervisory process. In addition, the instrument of a Regulation ensures that identical rules apply to CRAs across Europe (and not slightly different national rules implementing a EU directive as it is the case in the banking and insurance sector).

*Availability of supervisory skills and experience with regard to CRA supervision*

Another aspect to be considered in this respect is the availability of supervisory skills under the different options. Lack of supervisory skills and experience would reduce the efficiency of CRA supervision. While under option 1 and 2 the responsibility for supervising CRAs lies with the staff of national competent authorities, the responsibility would be shared among ESMA and national competent authorities under option 3a) and only be with ESMA staff under option 3b). It is important to note that due to the fact that the CRA Regulation only entered into force at the end of 2009 and will be fully applied only from end of 2010 there is not yet relevant supervisory experience with regard to CRA supervision in the EU. Staff of national competent authorities therefore does not have much advantage over future ESMA staff in this respect. In addition probably some of the future ESMA CRA staff (including national experts seconded from national competent authorities) will be recruited from the pool of supervisors currently dealing with CRAs at national level/ and in the CESR CRA Standing Committee.

In the medium term, option 3 b is preferable to the other options, as under option 1-3a) certain supervisors will only be in charge for the supervision of a small number of CRAs[35] which makes the gathering of experience more difficult, while ESMA staff will be dealing under option 3b with all European CRAs (currently around 50) which will allow its staff to quickly acquire expertise and experience. In addition ESMA staff will also be in charge for developing technical standards on CRAs which will further strengthen their CRA expertise. Given the relatively small number of CRAs active in the EU it is more efficient to concentrate the CRA expertise in one supervisory authority instead of having several supervisors being in charge for a small proportion of the market. Nevertheless also under option 3b national supervisors would be involved in CRA supervision, first through their role in ESMA's

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[34] The option to mandate audit firms with carrying out inspections (under the full responsibility and following instructions of the competent authority) is provided for in a number of jurisdictions, eg in Germany.

[35] For instance the Portuguese supervisory authority will be under the current CRA Regulation the home supervisor for only one CRA, the Slovakian supervisor for two CRAs.

decision making process, and second when supporting ESMA in the supervision of e.g. smaller local CRAs.

*Budgetary considerations*

Under option 1 Member States would have to fully finance the supervision of CRAs carried out by their national competent authorities with the involvement of CESR which is also funded by Member State contributions. The extent to which Member States will charge fees and/or current contributions to the supervised CRAs is not yet known and will probably vary across Member States. Under option 2 ESMA will assume an enhanced coordination function and the power to settle disputes which would probably reduce overall coordination costs among supervisors. The revenues of ESMA will consist of contributions from the competent authorities and a subsidy from the Community[36]. It follows that under option 2 there will be an overall reduction of costs, the costs for Member States will be reduced while the costs for the EU budget will be higher than under option 1 due to the co-financing of ESMA. Under option 3 and especially under sub-option 3 b) we would expect a further reduction in overall cost of supervision since centralising the supervisory activities in ESMA creates some economies of scale which imply an overall reduction of costs in an aggregated level within the EU. The decrease in overall cost for CRA supervision is also due to the fact that there will be less coordination costs (e.g. the fact that under the current legal framework CESR has to transmit back and forward several documents to the CRAs and competent authorities creates an excessive administrative burden) for national competent authorities and ESMA which will allow to considerably simplify and shorten the registration process. Currently there is no data on the administrative costs in Member States as they have not yet put in place the supervisory regime; however considerable savings are to be expected for Member States, even if the savings will be mitigated by the national contribution to the ESMA budget and their role in supporting ESMA's investigation activities and carrying out specific supervisory tasks under ESMA's responsibility. Due to ESMAs responsibility for CRA supervision and the Community contribution to the ESMA budget, there will be an increase in costs for the Community budget under option 3. However, this cost increase will be mitigated by the fact that ESMA will be entitled to charge fees on the supervised entities (see 9.3.) [37]

### 7.4. Aligned incentives

Under the current supervisory framework (option 1), competent authorities in the Member States may perceive the dimension of CRA supervision from a national perspective missing sometimes a full picture of the global nature and impact of CRA's activities. In some cases the impact of a CRA's activity may be much more significant outside the Member State where the CRA is located and whose competent authority is primarily responsible for supervision and enforcement. While it is true that other members of the college may contribute to the overall view of the CRA, it still could create conflicts that a supervisor, which is used to being responsible for its home financial market and accountable to its national political institutions,

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[36] According to the proposal for the ESMA Regulation, ESMA will be financed through 40 % European Union funds and 60 % through contributions from Member States. (Recital 50 of the Presidency compromise text dated 7 December 2009, available at: http://register.consilium.europa.eu/pdf/en/09/st16/st16751-re01.en09.pdf)

[37] To what extent the amount of fees will cover ESMA's cost for supervising CRAs will depend on the implementing measures which will specify situations when fees are due and the amount of fees. The regimes in Member States for charging fees on supervised entities are very divergent.

has to take the main responsibility for activities with pan- European reach affecting primarily financial markets outside its home jurisdiction.

While the activity of CRAs has an impact throughout the EU, only the home competent authority, i.e. the competent authority of the Member State in which the CRA is established, will be able to charge registration and supervisory fees. This may have the consequence that host competent authorities are less committed in participating and contributing to the supervisory work which may further affect the adequacy of the supervisory capacity of the home competent authority under Option 1.

In this regard, neither Option 1 nor Option 2 may offer satisfactory results, with the Option 2 leading to a slightly better outcome in terms of co-ordination of supervisory efforts due to ESMA's involvement.

Only Options 3a and 3b fully ensure that the supervisory authority(ies) in charge for supervising CRAs in the EU have sufficient capacity and leverage to deal with supervisory issues arising at the largest CRAs. ESMA will have the European perspective which is necessary to perform an adequate supervision with regard to CRAs with pan-European reach.

Option 3a may be considered as more proportionate in the sense that it retains the supervision of smaller CRAs at local (national) level.

### 7.5. Result

| Criteria<br><br>Options | Single point of contact. Clear competences | Consistent application | Efficiency gains | Adequacy |
|---|---|---|---|---|
| 1. Baseline (current CRA Regulation) | 0 | 0 | 0 | 0 |
| 2. College structure and ESMA | + | + | + | + |
| 3a. ESMA oversees directly some CRAs (except local players) | - | + | ++ | +++ |
| 3b. ESMA oversees directly all CRAs | +++ | +++ | +++ | ++ |

After due consideration of the impacts of all specific policy options and their advantages and disadvantages compared with the baseline scenario, it has been concluded that Option 3b

(direct oversight by ESMA of all EU-registered CRAs) addresses most comprehensively the objectives set before this Commission initiative.

The analysis in particular shows that direct supervision of CRAs at European level is more efficient than Option 2 consisting of a college structure as foreseen in the current CRA Regulation coupled with enhanced ESMA powers like monitoring compliance of competent authorities and dispute settlement provided by the ESMA Regulation. However, this finding does not suggest that supervision of other financial institutions like banks and insurance companies could also most efficiently be provided at European level. As described above, the structure and business model of CRAs varies considerably from the ones of banks and insurance companies and therefore a different supervisory model may be more appropriate for other financial sectors.[38]

Given the global nature of the rating activity a more consolidated supervision of the credit rating industry had been considered as more advantageous already at the time when the CRA Regulation was adopted. However at that moment the creation of such an agency for CRA oversight purposes only was eventually considered disproportionate. Currently however, taking into consideration the position of the European Parliament during the negotiation of the CRA Regulation and the general approach on the text establishing ESMA agreed at the ECOFIN on 2nd December, the level of political acceptability for this solution is very high.

With regard to the proportionality of the preferred option, a more centralised oversight of this industry would lead to streamlined decision-making process and to a public oversight of the CRA industry that would cover the EU territory without the risks of supervisory gaps or overlaps between national jurisdictions, existing currently. These risks have been more evident during the financial crisis; therefore it is proportionate in comparison to the costs that a crisis might entail to fill the supervisory gap.

At the same time the proposals would not be made in the areas where effective oversight of existing regulated entities is already ensured at national level. In this respect, in the case of use of credit ratings by individual financial entities which are supervised at national level, national supervisors would remain responsible for the supervision of the use of credit ratings by those individual entities. Moreover, as national supervisors would be able to collect specific information about the use of credit ratings, they should be able, to request ESMA to examine the withdrawal of a credit rating agency's registration or the suspension of the use of credit ratings. In all, the contemplated provisions would not go beyond what is strictly necessary to achieve the objectives pursued.

## 8. FURTHER ANALYSIS OF THE PREFERRED OPTION: THE NEED FOR AN EFFECTIVE SANCTIONING REGIME

As mentioned in Sections 1 and 3, the forthcoming amendment of the CRA Regulation will review the supervisory structure applicable to CRAs to adjust it to the new European supervisory architecture. Within this framework, the preferred option chosen above is that the ESMA will assume exclusive supervisory powers over CRAs entrusted to it in the CRA Regulation. Accordingly, the ESMA will be entrusted with an appropriate authority to

[38] See above p. 7, 8. The limited number of CRAs, the mobility of rating services and the cross boarder impact of ratings are specific to the rating sector.

investigate and enforce legislation. ESMA's additional responsibilities entail additional resources. In order for ESMA to fulfil its new supervisory powers concerning CRAs, it is necessary to entrust it also with the power to recommend the adoption of sanctions and periodic penalty payments by the Commission.

### 8.1. Introduction

Currently, Article 36 of the CRA Regulation mandates Member States to adopt rules on penalties applicable in the case of provisions violating the CRA Regulation by 7th December 2010, and to take all necessary measures to ensure that they are implemented.

The fact that ESMA will be entrusted with exclusive supervisory powers over CRAs implies that the sanctioning regime of the CRA Regulation is to be reviewed and enhanced in order to create a transparent and effective system within which ESMA will be able to deploy all its supervisory powers. The sanctioning regime of the CRA Regulation will not entail the assessment of the functioning of a given market and the market behaviour of the CRA; the sanctioning regime will involve only the assessment of the individual behaviour of specific CRAs.

The sanctioning regime in the CRA Regulation will have different objectives: First the deterrent effect to keep at bay the risk that CRAs breach the provisions of the Regulation. And second, once an offence has been committed, restorative measures are called in; sanctions are to be strong enough to compel the CRA to restore the situation. In order to fulfil these objectives, sanctions are to be effective, proportionate and dissuasive.

The CRA Regulation imposes organisational requirements, operational requirements and disclosure requirements on CRAs. Given the nature of these requirements it is appropriate that breaches of the CRA Regulation are qualified as administrative offences as opposed to more serious criminal offences which would require national criminal courts issuing the sanctions. Most Member States qualify breaches of similar types of requirements (e.g. provisions in MiFID on organisational requirements or conflicts of interests) as administrative offences.

However, some behaviour of persons involved in rating activity may in addition to infringing the CRA Regulation qualify as criminal offence (e.g. fraud) according to criminal legislation of the Member State where the act is committed.

In order to build an effective sanctioning regime, apart from pecuniary sanctions (fines) the CRA Regulation should provide a number of other enforcement measures in case a CRA infringes provisions of the CRA Regulation. Those measures may be understood as sanctions in a broader sense. All in all, the sanctions to be envisaged in the CRA Regulation are the following:

- Withdrawal of registration. It should be envisaged for the most serious breaches of the Regulation, notably "where the CRA has seriously and repeatedly infringed the provisions of the Regulation governing the operating conditions for credit rating agencies". As a result of the withdrawal the CRA has to stop immediately its rating activity.

- Periodic penalty payment. It should be foreseen, as it is the case in the Council Regulation on the implementation of the rules on competition[39], in situations in which the CRA is compelled by the ESMA to act in a specific manner at a given deadline for instance to put an end to an infringement, supply information or submit to an investigation or an inspection. The penalty to be imposed by the Commission at ESMA's request for each day of delay is to be calculated according to the parameters established in the CRA Regulation. If the CRA complies with the order by ESMA within the given deadline, no penalty payment will be imposed. Therefore a penalty payment has primarily compelling effect but does not sanction/compensate a breach of a substantive requirement of the Regulation.

- Fines. The Commission based on a recommendation by ESMA may impose a fine on a CRA where a CRA infringes, intentionally or negligently, specific provisions containing obligations/prohibitions. All the different sanctions described above are complementary parts of an effective enforcement regime. Limiting the sanctioning powers to the power to withdraw a registration would not be sufficient as this power may only be applied for serious or repeated breaches of the CRA Regulation and would be disproportionate in most of the cases. Also, the power to require a CRA to bring an infringement to an end (Article 24 (1) d) CRA Regulation) coupled with the imposition of periodic penalty payments if the CRA does not comply with the order in a given deadline is not sufficient. While this measure may for the short term restore compliance with the CRA Regulation, it does not have a strong deterrent effect. A CRA may at first comply with the order of ESMA, but may after a while commit again the same breach, if there are no pecuniary sanctions for the infringement. The possibility of the Commission imposing pecuniary sanctions at ESMA's request, is therefore necessary in order to provide a proportionate reaction to individual breaches of the Regulation which do not justify the immediate withdrawal of the registration and in order to create a deterrent effect.

## 8.2. Problem definition

ESMA will execute exclusive supervisory powers over CRAs. It is evident that an effective supervision needs to be accompanied by an effective sanctioning regime. However, it is necessary to assess whether sanctions are to remain in the remit of the Member States or whether the Commission, based on recommendations by ESMA, should be entrusted with the sanctioning power. The deficiencies of the current system are the following:

### *8.2.1. Uneven playing field*

The CRA Regulation constitutes a single rulebook for the activities performed by CRAs. However, in the current CRA Regulation, each Member State is to set up its national system of penalties. Where substantial differences exist in the sanctioning regimes, this may result in an uneven playing field, as the same offence can be punished in many different ways in different Member States. Such different treatment can lead to a distortion of competition between Member States, as CRAs might choose the best location for their business taking into account how sanctions are to be applied. With different sanctioning regimes, there is room for regulatory arbitrage, as CRAs will take advantage of a regulatory difference between the markets.

[39] Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the treaty, OJ L1 of 4.1.2003, p.1.

*8.2.2. Inconsistent application*

Within the current CRA Regulation, each Member State, after having set up its national system of penalties, will have to assess each breach by a CRA of the provisions of the CRA Regulation and impose a fine. This situation might lead to a different application of sanctions in the different Member States, as the competent authorities to assess the individual breach committed by a CRA will be different in each case. The rules of equality and proportionality that the sanctioning authority will apply may not be the same in all Member States.

## 8.3. Objectives

The sanctioning regime should be aimed at ensuring that the following objectives are met:

*8.3.1. Ensure a level playing field*

Given the global nature of the CRA business and the use of a credit rating at the same time in several Member States, it is particularly important to submit CRAs to the same level of sanctions within all the Member States of the EU. Otherwise, CRAs could choose as their place of establishment the Member State in which the lowest level of sanctions exists.

*8.3.2. Ensure a consistent application*

As credit ratings are used by financial institutions and governments in all Member States, if a CRA breaches one of the provisions of the CRA Regulation, the CRA's misbehaviour will have consequences in a number of Member States. Therefore, the assessment of the CRA's misbehaviour and the consequent imposition of a sanction should be consistent in the different individual cases.

## 8.4. Options

The following policy options have been considered:

*8.4.1. Option 1 – Sanctions at national level*

This option would consist in maintaining the sanctioning powers at national level, as it is envisaged in the current CRA Regulation. As according to our preferred option (see 7.5. above) ESMA would be allocated the exclusive supervisory powers over CRAs, it would be in the remit of ESMA to determine whether a CRA has breached the provisions of the CRA Regulation. Once a breach by a CRA would have been determined, the competent national authority of the Member State in which the CRA is established will be the one imposing a sanction in conformity with the national sanctioning rules (i.e. rules of procedure, appeals, etc).

*8.4.2. Option 2 – Sanctions at the level of ESMA*

This option would imply that ESMA is entrusted not only with the exclusive supervisory powers, but also with the ultimate power to impose sanctions to CRAs in case they commit a breach of a provision of the CRA Regulation.

*8.4.3. Option 3 – Sanctions at Commission level*

This option would imply that after the performance by ESMA of its supervisory responsibilities on a given case of breach of a provision of the CRA Regulation by a CRA, ESMA would transmit the file with its recommendations to the Commission, which would take a decision on imposing a fine on the CRA.

## 8.5. Comparing the options

The impacts of identified policy options should be considered in the context of the objectives set in point 8.3.

*8.5.1. Ensure a level playing field*

In the case of Option 1, as Member States will remain responsible for issuing pecuniary sanctions, no level playing field within the EU on CRAs will be ensured. Even if the CRA Regulation introduces a complete list of sanctions that are to be applied and sets detailed rules how to determine the amount of a fine, there would still be some discretion by each national authority in determining a fine In addition, separating the authority which supervises from the one which sanctions would make the system more complex and less efficient as the sanctioning authority may be required to reassess the breach (including its gravity, duration, mitigating/aggravating circumstances). The fact that sanctioning decisions could be appealed to different national courts would add another source of potential divergence regarding the amount of fines but also the determination of a breach.

In the case of Option 2, ESMA would be entrusted with sanctioning powers and the Commission would keep the possibility to control the decisions taken by ESMA in imposing fines on credit rating agencies. Therefore, the CRA Regulation should establish:

- a list of breaches of the provisions of the CRA Regulation that can be enforced by fines when the CRA acted intentionally or negligently;

- minimum and maximum amounts of fines for each breach, taking into account the seriousness and gravity of the infringement committed and the effect on the credit ratings issued by the CRA;

- objective parameters to be taken into account by ESMA in determining the amount of the fine;

- the Commission should adopt rules specifying further detailed criteria for ESMA for the establishment of the amount of a fine. Moreover, ESMA will have to stick in all cases to the same rules of equality and proportionality.

However, this option could raise some concerns of consistency with the Community acquis and notably the jurisprudence of the European Court of Justice in the Meroni case[40].

[40] Case 9/56 Meroni [1958] ECR 133 according to which agencies/authorities may not be delegated the power to take decisions which require difficult choices in reconciling various objectives laid down in the Treaty amounting to the execution of actual economic policy. Clearly defined executive powers can be delegated to an agency including powers, that involve the need to interpret Community law provisions to determine their application and which leave the authority a certain margin of appreciation in applying these rules.

According to option 3 the same legal framework should be applied by the Commission to take a decision on a sanction, at ESMA's request. The exercise of sanctioning powers by the Commission should in principle satisfy the objective of ensuring a level playing field for supervised entities, and would be fully consistent with the jurisprudence of the Court in the Meroni case. Nonetheless, the resulting split between supervisory activity of the ESMA (on-site inspections, hearings of stakeholders, finding of a breach) and the sanctioning itself would make the entire process more complex, as the file would need to be re-examined by the Commission before a decision could be taken.

*8.5.2. Ensure a consistent application*

Concerning Option 1, even in the case where the sanctions would be harmonised in the CRA Regulation, if they are applied by the national competent authorities, it is very difficult to ensure that they are applied in a fully consistent way throughout the EU. This risk of divergence could to a certain extent be mitigated by the issuance of guidance by ESMA; however, as the sanction would be imposed by a national authority, this authority would legally be responsible for the finding of a breach and setting the right amount of fine. In addition, the right of appeal by the CRA would be exercised in the relevant court of the Member State which might assess the cases in a different way than other national courts in other Member States.

ESMA (Option 2) would be better placed than national regulators to exercise the sanctioning powers over credit rating agencies, since different national regulators could take different sanctions concerning the same breach of law. These national discrepancies would be harmful to an effective EU supervision and, precisely, reduce the effects of a single set of rules. The general rules of procedure that ESMA would apply would be the ones set in the Regulation establishing ESMA. Finally, the European Court of Justice would have jurisdiction to fully review the measures taken by ESMA, including cancelling, increasing or reducing a fine or periodic penalty payment imposed by ESMA. However, this option could raise some concerns of consistency with the Community acquis and notably the jurisprudence of the European Court of Justice in the Meroni case.

In the case of Option 3, the CRA framework should be ultimately enforced by the Commission, which would be empowered to take decisions on fines and periodic penalty payments, at ESMA's request. This option would ensure consistent sanctions at European level, which would be subject to review by the ECJ, and would be consistent with the Community acquis and notably the Meroni caselaw.

It seems therefore appropriate to grant the power to impose fines and periodic penalty payments to the Commission, acting at ESMA's request.

| Criteria<br><br>Options | Level playing field | Consistent application |
|---|---|---|
| 1. Sanctions at national level | + | + |
| 2. Sanctions at the level of ESMA | +++ | +++ |

| | | |
|---|---|---|
| 3. Sanctions at the level of the Commission | +++ | +++ |

| |
|---|
| Therefore, the best solution to ensure an efficient sanctioning regime is to grant the Commission the necessary sanctioning powers to be exercised under a well defined framework and based on the recommendations of ESMA. This framework should include all necessary elements to allow the Commission to exercise its sanctioning powers under transparent and objective parameters. |

## 9. ANALYSIS OF IMPACTS

It has been shown that the solution which best addresses the objectives set for this Commission initiative is the direct oversight by ESMA of all EU-registered CRAs and the centralisation of the sanctioning power with the Commission, acting on a recommendation by ESMA.

| **Advantages** | | **Disadvantages** | |
|---|---|---|---|
| 1 | Streamlined decision making process – no conflicts over competence | 1 | Need to build oversight capacity from scratch |
| 2 | No risk of incoherent application of EU law across the Member States | 2 | Local CRAs expected to deal with an EU-level supervisor |
| 3 | Clear efficiency gains – heavy co-ordination procedures are avoided and resources and expertise are pooled in one organisation | | |
| 4 | Supervisor's perspective, capacity and mandate corresponds to the EU-wide reach of main players | | |
| 5 | Level playing field for the deterrent effect of sanctions and fully consistent application of sanctions throughout the EU | | |

As the current initiative aims to streamline supervision of credit rating agencies, its potential benefits can be deduced from the cost implications of the financial crisis, in which credit rating agencies played a non-negligible role. Even when attributing to credit rating agencies only a fraction of the direct and indirect losses caused by the crisis, the benefits of an effective and efficient supervisory system are vast.

### 9.1. Impacts on the credit rating agencies

CRAs would operate in a much simpler supervisory environment, with only one public authority – the ESMA – assuming overall competence for their supervision and one public authority, the Commission, responsible for sanctions under the CRA regulation. Significant efficiency gains may be expected in terms of the use of CRAs' resources on compliance with the CRA Regulation. The more efficient supervisory structure also means that decisions in individual cases would be taken in a timely manner; the risks of incoherent application or conflicting competences would be eliminated.

Certain smaller CRAs may feel disadvantaged by the fact that the ESMA will not have a presence in the Member State of their establishment. Certain arrangements, like accepting documentation in any of the EU official languages or delegating some specific tasks (e.g. hearing of a person, carrying out on-site inspections) to the supervisory authority at national level, would be used to mitigate this difficulty.

### 9.2. Impacts on the users of ratings

The interests of the users of ratings, in terms of higher quality of ratings, greater independence and transparency of CRAs, are going to be more effectively protected as a result of establishing centralised EU supervision of all CRAs. It will be possible to report breaches of and deficient compliance with the CRA Regulation to a single oversight authority in Europe specialised in dealing with cases involving rating activity and fully prepared to pursue cross-border cases.

Both rated entities and users of credit ratings will be better protected as there will be a fully coherent and consistent application throughout the EU of the CRA Regulation.

### 9.3. Impacts on the ESMA - resources and funding

The ESMA will become responsible for direct supervision of credit rating agencies. This will require building its supervisory capacity. The ESMA will need to be sufficiently funded and staffed to fully exercise its authority in this field. It should be able to make effective use of supervisory powers (like examining records and launching investigations).

*Staffing and other operational expenditure*

According to current estimations from the CESR secretariat and an assessment of DG Internal Market and Services the CRA oversight activity will require 12 new staff members (6 temporary agents and 6 seconded national experts) in addition to the 3 staff that are currently working on CRAs in CESR and that are covered by the budget for ESMA already provided for in the ESMA Regulation. Following this approach estimated staffing costs of this proposal would amount to 1.574 Million Euro in the first year of the ESMA activity (2011). In addition to staffing costs 628.000 Euro expenditure is foreseen for building, equipment and administrative costs (including rental of building, IT costs, telecommunication costs, meeting/travelling expenses and translation costs) and 300.000 Euro for operational costs (in particular the organisation of on-site inspections and the setup of a collaborative environment to work with national competent authorities on enforcement cases). According to these estimates total expenditure of ESMA on CRA supervision would amount to ca. 2,502 Million Euro in 2011. This expenditure was not included in the estimated ESMA budget accompanying the proposal for setting up the ESMA as it is caused by entrusting ESMA with

direct supervisory powers over CRAs as proposed by this amendment to the CRA Regulation. The evolution of the expenditure in subsequent years depends among other things on the number of supervised entities but from today's perspective we would not expect significant changes.

According to the estimations of DG Internal Market and Services, the role of the Commission in sanctioning breaches of the CRA Regulation based on recommendations of ESMA will require 4 officials. This role would include the adoption of fining and periodic penalty payments decisions on CRAs, carrying out own enquiries, hearing of the CRAs and persons concerned, responding to requests for access to file, defending fining and periodic penalty payments decision before the Courts and collecting the fines.

*Funding*

According to Article 48 (1) of the proposal for the ESMA Regulation, the revenues of ESMA shall consist in particular of a) contributions from the national competent authorities, b) a subsidy of the European Union and c) any fees paid to the Authority in the cases specified in relevant legislation.

Consequently, the CRA oversight activity would be funded from the overall ESMA revenues, including proceeds from fees charged from CRAs by the ESMA. It remains to be determined in secondary legislation to what extent supervisory fees could cover the costs incurred by the ESMA in the CRA supervision. Also full financing of ESMA's expenditures related to CRA supervision by the CRA industry should be considered.

*Fees to be charged*

ESMA should be entitled to charge fees for registration and other supervisory measures. The matters for which fees are due and the amount of the fees should be set in legislation. The power to adopt an act specifying the fees could be conferred in the CRA Regulation upon the Commission, which would also allow for a less time-consuming adaptation of fees if needed.[41] In general terms, the fees would be proportional to the costs incurred by ESMA and to the size and economic strengths of the credit rating agency. Implementing measures on fees will be subject to a separate IA.

*Fines and periodic penalty payments*

The fines and periodic penalty payments that the Commission will impose on credit rating agencies will become part of the EU general budget.

In cases when CRAs fail to pay the amounts due as fees, fines or periodic penalty payments decisions imposing the obligation to pay (e.g. a decision to register or to withdraw registration or a fining decision) would be directly enforceable in accordance with the rules of civil procedure in force in the territory where enforcement is to be carried out.

*Other impacts*

[41] The process would be that during the negotiations of the amendments to the CRA Regulation, the Commission would start working (with the involvement of CESR) on the implementing measures specifying the fees.

The ESMA will need to put in place effective co-operation arrangements with relevant 3rd country supervisors of CRAs to enable the functioning of rules allowing the use in the EU of the ratings produced in those 3rd jurisdictions. Last but not least, it will also need to develop close co-operation with supervisory authorities in the Member States, as their assistance on specific supervisory matters (e.g. during on-site inspections or in the context of supervising smaller CRAs) may be crucial.

### 9.4. Impacts on the Member States

Member States would not be expected to maintain comprehensive supervisory structures for the oversight of CRAs. Some supervisory capacity at the individual Member States' level would need to be secured for the issues related to the use of ratings.

### 9.5. Impacts on the competent authorities

Competent authorities would not be responsible for the supervision of the CRAs. They would nonetheless be expected to offer all necessary assistance to the ESMA and fulfil tasks delegated by ESMA. They would be entitled in some clearly defined circumstances to request the ESMA to take a concrete enforcement action.

### 9.6. Administrative burden

No additional administrative burden to CRAs is to be envisaged as this proposal is not going to modify the substantive requirements introduced by Regulation (EC) N°1060/2009. On the contrary, an immediate consequence of the centralization of supervision for CRAs is that the administrative burden will be reduced. No increase of administrative burden is expected in comparison to the baseline scenario.

The time for registration will be reduced from the current 2 to 7 months to a maximum of 65 working days. This will imply a substantial reduction of costs for CRAs as they will be able to start issuing credit ratings under the new regime earlier than under the old system.

Moreover, CRAs will no longer have to deal with several supervisors. The number of reporting obligations and other contacts will be reduced as CRAs will have to deal only with one supervisor.

There will be an increase in administrative burden for ESMA due to the fact that it will have to issue recommendations to the Commission when fines should be imposed on CRAs. However, the increase in burden will be limited as the information on which it bases such recommendations does not have to be collected only for that purpose but is anyway required in order for the Commission to justify a fine vis-à-vis the addressed CRA. In addition, there will be a decrease in administrative burden for ESMA due to the fact that some notification obligations (e.g. transmission of application copies to competent authorities) will not be necessary any more.

### 9.7. Impacts on the environment and employment

It is not expected that the changes in the CRA Regulation are going to have any impact on the natural environment or on the gender policy of the EU.

Concerning employment, as ESMA will be responsible for the registration and oversight of CRAs, the national supervisory authorities will have to devote fewer personnel to deal with

CRAs issues. ESMA will of course create new posts and some of the posts are offered to national experts seconded from national competent authorities. In the CRAs themselves, as the process of registration and supervision will be simplified and they will have to deal only with one supervisor, it is expected that they will slightly reduce the number of staff dealing with these issues.

### 9.8. Impacts on third countries

The Commission proposals to modify the supervisory architecture for the CRA industry would come at a time, when some non-EU jurisdictions are making efforts to either put in place or to strengthen their regulatory frameworks for the credit rating activity[42]. The forthcoming EU action is to focus on the supervisory architecture for CRAs – this area is traditionally determined by the legislative branch in response to national or regional specificities and it is rarely a subject of international debate or controversy, unless major problems of co-operation or effectiveness arise.

In this regard, it should be expected that the changes in the CRA Regulation would have a positive impact on EU relationships with third countries, as instead of having to deal with 27 competent authorities, third countries' supervisory authorities will deal only with one authority, ESMA, for any issue related to the supervision of CRAs. Moreover, as CRAs operate in a global manner and usually several subsidiaries and branches of the same CRA group participate in the issuance of a given credit rating, it is essential that third countries' authorities have a single contact in the EU. ESMA would be the European authority signing any future Memorandum of Understanding on the exchange of information or the coordination of supervisory activities, thus simplifying and strengthening the operational ties with supervisors from 3rd countries. Currently CESR is already negotiating with third countries' supervisory authorities the development of Memoranda of Understanding, which under the current legal framework would have to be signed by the national competent authorities.

### 9.9. Summary of the final outcome

In view of the conclusions reached in this impact assessment, the European Commission considers appropriate to present a proposal amending the Regulation on CRAs. The proposal should aim at solving the problems identified in this impact assessment:

– by entrusting ESMA with exclusive oversight powers over CRAs. ESMA will be granted powers to request information, to launch investigations, and perform on-site inspections. Where necessary, ESMA might require assistance of national securities regulators in those supervisory activities. The latter may also be delegated specific supervisory tasks (e.g. hearing of a person, carrying out on-site inspections), with the ESMA retaining overall responsibility for those activities.

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42 Some form of legal framework for the oversight and supervision of the CRAs is already in place or should be established in due time in Argentina, Brazil, China, Hong-Kong, India, Israel, Mexico, Russia, Singapore, South Africa, United Arab Emirates. International regulatory activity in this field is due to the G20 commitment to extend regulatory oversight and registration to Credit Rating Agencies to ensure they meet the international code of good practice, particularly to prevent unacceptable conflicts of interest. Cf. the official communiqué issued at the close of the G20 London Summit, available at: http://www.londonsummit.gov.uk/resources/en/news/15766232/communique-020409.

– by entrusting the Commission, on a recommendation from ESMA, with sanctioning powers within a well defined framework. Sanctions, including fines and periodic penalty payments, will be defined in such a way to provide a proportionate reaction to individual breaches and to create a deterrent effect. The Commission's decisions in this field would be subject to judicial review by the ECJ.

## 10. MONITORING AND EVALUATION

The Commission is the guardian of the Treaty and therefore will monitor how the Regulation on CRAs is implemented by ESMA.

The evaluation of the consequences of the application of the legislative measure could take place three years after the entry into force of the legislative measure in the form of a Commission report to the Council and the European Parliament. The Commission will be monitoring the application of the Regulation on CRAs, as amended, through ESMA and an extensive and continuous dialogue with all major stakeholders, including financial institutions and market participants (issuers, intermediaries and investors), and consumers. The assessment will be carried out along the following criteria: investor protection, effectiveness, market efficiency, legal certainty, administrative burdens.

## 11. ANNEX I - LIST OF CRAS ESTABLISHED IN THE EUROPEAN UNION IN 2009

Standard& Poor's with subsidiaries in: FR, DE, IT, ES, SE, UK

Moody's with subsidiaries in: CY, CZ, FR, DE, IT, ES, UK

Fitch with subsidiaries in: FR, DE, IT, PL, ES, UK

Coface with subsidiaries in: FR, BE, LUX, UK

DBRS (to be established, UK)

Creditreform (AT)

Kreditschutzverband von 1870 (AT)

Bulgarian Credit Rating Agency (BG)

National Credit Rating Agency (BG)

Global Ratings (BG)

Capital Intelligence Limited (CY)

Euler Hermes Rating (DE)

ASSEKURATA (DE)

URA Rating Agentur AG (DE)

Prof. Dr. Schneck Rating (DE)

Creditreform Rating AG (DE)

RS Rating Services AG (DE)

MAR-Rating GmbH (DE)

Lince Spa (IT)

Capp&CAPP Srl (IT)

Companhia Portuguesa de Rating (POR)

European Rating Agency (SK)

ECRAI (SK)

AM Best (UK)

## 12. ANNEX II PROBLEM TREE

**Problem tree:**