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Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

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

(Text with EEA relevance)

{SEC(2011) 1354 final}

{SEC(2011) 1355 final}

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

Credit rating agencies are important financial market participants and need to be subject to an appropriate legal framework. Regulation (EC) No 1060/2009 on credit rating agencies¹ (CRA Regulation) entered into full application on 7 December 2010. It requires credit rating agencies (CRAs) to comply with rigorous rules of conduct in order to mitigate possible conflicts of interest, ensure high quality and sufficient transparency of ratings and the rating process. Existing CRAs had to apply for registration and to comply with the requirements of the Regulation by 7 September 2010.

An amendment to the CRA Regulation (Regulation (EU) No 513/2011) entered into force on 1 June 2011, entrusting the European Securities and Markets Authority (ESMA) with exclusive supervisory powers over CRAs registered in the EU in order to centralise and simplify their registration and supervision at European level².

Whilst providing a good basis, a number of issues related to credit rating activities and the use of ratings have not been sufficiently addressed in the existing CRA Regulation. These relate notably to the risk of overreliance on credit ratings by financial market participants, the high degree of concentration in the rating market, civil liability of credit rating agencies vis-à-vis investors, conflicts of interests with regard to the issuer-pays model and CRAs' shareholder structure. The specifics of sovereign ratings which became evident during the current sovereign debt crisis are also not specifically addressed in the current CRA Regulation.

The European Commission pointed to these open issues in its Communication of 2 June 2010 ("Regulating financial services for sustainable growth")³ and in a consultation paper of the Commission services of 5 November 2010⁴ announcing the need for a targeted review of the CRA Regulation which is delivered with this proposal.

On 8 June 2011, the European Parliament issued a non-legislative resolution on CRAs⁵. The report supports the need to enhance the regulatory framework for credit rating agencies and to take measures to reduce the risk of overreliance on ratings. More specifically, the European Parliament supports, amongst others, enhanced disclosure requirements for sovereign ratings, the establishment of a European Rating Index, increased disclosure of information on structured finance instruments and civil liability of credit rating agencies. The European Parliament also regarded stimulation of competition as an important task and considered that the establishment of an independent European Credit Rating Agency should also be explored and assessed by the Commission.

At an informal ECOFIN meeting of 30 September and 1 October 2010 the Council of the European Union acknowledged that further efforts should be made to address a number of

¹ Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, OJ L 302, 17.11.2009.

² Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation (EC) No 1060/2009 on credit rating agencies, OJ L 145, 31.5.2011.

³ COM(2010)301 final.

⁴ Available at http://ec.europa.eu/internal_market/consultations/2010/cra_en.htm.

⁵ <http://www.europarl.europa.eu/oeil/FindByProcnum.do?lang=en&procnum=INI/2010/2302>.

issues related to credit rating activities, including the risk of overreliance on credit ratings and the risk of conflict of interests stemming from the remuneration model of rating agencies. The European Council of 23 October 2011 concluded that progress is needed on reducing overreliance on credit ratings.

In addition, the European Securities Committee and the European Banking Committee composed of representatives of Member States' ministries of finance discussed the need to further strengthen the regulatory framework for credit rating agencies at their meetings of 9 November 2010 and 19 September 2011.

At the international level, the Financial Stability Board (FSB) issued in October 2010 principles to reduce authorities' and financial institutions' reliance on CRA ratings⁶. The principles call for removing or replacing references to such ratings in legislation where suitable alternative standards of creditworthiness are available and for requiring investors to make their own credit assessments. Those principles were endorsed by the G20 Seoul Summit in November 2010.

The Commission has recently addressed the question of overreliance on ratings by financial institutions in the context of the reform of the banking legislation⁷. The Commission proposed the introduction of a rule requiring banks and investment firms to assess themselves the credit risk of entities and financial instruments in which they invest and not to simply rely on external ratings in this respect. A similar provision is proposed by the Commission in the draft amendment to the Directives on UCITS and on managers of alternative investment funds⁸, which are proposed in parallel to this proposal for a Regulation.

2. RESULTS OF CONSULTATIONS WITH THE INTERESTED PARTIES AND IMPACT ASSESSMENTS

The European Commission conducted a public consultation from 5 November 2010 to 7 January 2011 presenting various options to address the issues identified. The Commission received approximately 100 contributions from stakeholders which have been taken into account in drafting this proposal. A summary of the responses to the consultation paper can be found at

http://ec.europa.eu/internal_market/securities/docs/agencies/summary-responses-cra-consultation-20110704_en.pdf.

On 6 July, the Commission services held a roundtable in order to obtain further feedback from relevant stakeholders on these issues. A summary of the roundtable can be found at

⁶ http://www.financialstabilityboard.org/publications/r_101027.pdf.

⁷ Commission proposal of 20 July 2011 for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, COM(2011) 453 final. See point (b) of Article 77.

⁸ Commission proposal of 15 November 2011 for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings of collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Funds Managers in respect of the excessive reliance on credit ratings, COM(2011) xxx final.

http://ec.europa.eu/internal_market/securities/docs/agencies/roundtable_en.pdf.

An impact assessment has been produced for this proposal. It can be found at

http://ec.europa.eu/internal_market/securities/agencies/index_en.htm.

The impact assessment identified the following problems:

- the requirements to use external credit ratings in legislation, the excessive use of external ratings for internal risk management by investors, the investment strategies directly linked to ratings as well as the insufficient information on structured finance instruments results in overreliance on external credit ratings leading to procyclicality and "cliff" effects⁹ in capital markets;
- insufficient objectivity, completeness and transparency on the sovereign rating process, together with the overreliance, leads to "cliff" and contagion effects of sovereign rating changes;
- high concentration in the credit rating market, high barriers to entry into the market of credit ratings and lack of comparability of ratings result in limited choice and competition in the credit rating market;
- insufficient right of redress for users of ratings suffering losses due to an inaccurate rating issued by a CRA that infringes the CRA Regulation;
- potentially undermined independence of CRAs due to conflicts of interest arising from the "issuer-pays" model, ownership structure and long tenure of the same CRA; and
- insufficiently sound credit rating methodologies and processes.

The general objective of the proposal is to contribute to reducing the risks to financial stability and restoring the confidence of investors and other market participants in financial markets and ratings quality. Different policy options were considered in order to address the identified problems and thus reach the corresponding specific objectives:

- to diminish the impact of "cliff" effects on financial institutions and markets by reducing reliance on external ratings;
- to mitigate the risks of contagion effects linked to sovereign ratings changes;
- to improve credit rating market conditions, since there is limited choice and competition in the credit rating market, with a view to improving the quality of ratings;
- to ensure a right of redress for investors, since currently there is an insufficient right of redress for users of ratings who have suffered losses due to a credit rating issued by a CRA that has infringed the CRA Regulation; and

⁹ "Cliff effects" are sudden actions that are triggered by a rating downgrade under a specific threshold, where downgrading a single security can have a disproportionate cascading effect.

- to improve the quality of ratings by reinforcing the independence of CRAs and promoting sound credit rating processes and methodologies. Currently, the independence of CRAs is potentially undermined due to conflicts of interest arising from the "issuer-pays" model, the ownership structure and long tenure of business relations with one and the same CRA.

The preferred policy options are set out in section 3.4. below and reflected in this proposal. These options are expected to reduce overreliance by financial institutions on external ratings by reducing the importance of external ratings in financial services legislation. In addition, issuers' disclosure regarding the underlying asset pools of structured finance products is expected to help investors to make their own credit risk assessment, rather than leaving them to rely solely on external ratings.

The transparency and quality of sovereign ratings will be improved through verification of underlying information and publication of the full research report accompanying the rating. Comparison of ratings from distinct rating agencies, facilitated by promoting common standards for rating scales and a European Rating Index (EURIX), is expected to improve choice and optimise rating industry structure. Also, mandatory rotation of CRAs would not only substantially reduce the familiarity threat to CRA independence resulting from a long business relationship between a CRA and an issuer, but would also have a significant positive effect on improving choice in the rating industry by providing more business opportunities for smaller CRAs.

In terms of investor protection, setting up a right of redress for investors against CRAs should provide strong incentives for CRAs to comply with legal obligations and to ensure high quality ratings. Independence of ratings will be improved by introducing a requirement for issuers to change CRA periodically and enhancing the independence requirements on the ownership structure of CRAs. Also, a CRA should not be able to provide solicited ratings for an issuer and its products simultaneously.

In addition, transparency and quality of ratings would be improved by strengthening the rules on the disclosure of rating methodologies, by introducing a process for the development and approval of rating methodologies, including the requirement for CRAs to communicate and justify the reasons for modifications to their rating methodologies and by requiring CRAs to inform issuers sufficiently in advance of the publication of a rating.

In terms of costs, there would be additional costs for financial firms resulting from the requirements to enhance internal risk management and the use of internal rating models for regulatory purposes and for issuers due to enhanced disclosure requirements. CRAs will also incur additional recurring compliance costs to mitigate risks of contagion effects linked to sovereign ratings. However, measures to improve competition would not significantly increase the costs for CRAs. The policy option related to civil liability of CRAs towards investors is expected to cause compliance costs due to the need to insure their civil liability or, in the absence of the insurability, to create a financial buffer to cover potential claims from investors. Finally, the preferred options dealing with CRA independence are not expected to entail any significant costs.

3. LEGAL ELEMENTS OF THE PROPOSAL

3.1. Legal basis

The proposal is based on Article 114 TFEU.

3.2. Subsidiarity and proportionality

According to the principle of subsidiarity (Article 5(3) of the TEU), action at the EU level should be taken only where the aims envisaged cannot be achieved sufficiently by Member States alone and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the EU. The business of credit rating agencies is global. Ratings issued by a credit rating agency based in one Member State are used and relied upon by market participants throughout the EU. Failures or the lack of a regulatory framework for credit rating agencies in one specific Member State could adversely affect market participants and financial markets EU-wide. Therefore, sound regulatory rules applicable throughout the EU are necessary to protect investors and markets from possible shortcomings. Therefore any further actions in the field of CRAs can best be achieved by EU action.

The proposed amendments are also proportionate, as required by Article 5(4) of the TEU. The amendments do not exceed what is necessary to achieve their objectives. The conditions of independence of credit rating agencies are particularly enhanced: issuers are required to regularly change the credit rating agency they pay to issue credit ratings and to appoint different credit rating agencies to issue credit ratings on them and on their debt instruments. These obligations, although limiting business freedom, are proportionate to the objectives pursued and take account of the regulatory environment. They only apply regarding a service in the public-interest (credit ratings that can be used for regulatory purposes) by certain regulated institutions (credit rating agencies) under certain conditions (issuer-pays model) and, in the case of rotation, on a temporary basis. Credit rating agencies are, however, not prevented from continuing to provide credit rating services in the market: a credit rating agency which is required to refrain from providing credit rating services to a particular issuer would still be able to provide credit ratings to other issuers. In a market context where the rotation rule applies across the board, business opportunities will arise since all issuers would need to change credit rating agency. Also, credit rating agencies may always issue unsolicited credit rating on the same issuer, capitalising on their experience.

The amendments also foresee that investors and large credit rating agencies are limited regarding some investment choices. Investors holding a participation of at least 5% in a CRA are prevented to hold more than 5% in any other CRA. This restriction is necessary to guarantee the perception of independence of CRAs, which could be affected should the same shareholders or members be significantly investing in different credit rating agencies not belonging to the same group of credit rating agencies, even if those shareholders or members are not in position to legally exercise dominant influence or control. This risk is higher considering that EU registered CRAs are unlisted, and therefore less transparent, companies. Nevertheless, in order to ensure that purely economic investments in credit rating agencies are still possible, the prohibition to simultaneously invest in more than one credit rating agency is not to be extended to investments channelled through collective investment schemes managed by third parties independent from the investor and not subject to his or her influence.

3.3. Compliance with Articles 290 and 291 TFEU

On 23 September 2009, the Commission adopted proposals for Regulations establishing EBA, EIOPA, and ESMA. In this respect the Commission wishes to recall the Statements in relation to Articles 290 and 291 TFEU it made at the adoption of the Regulations establishing the European Supervisory Authorities according to which: "As regards the process for the adoption of regulatory standards, the Commission emphasises the unique character of the financial services sector, following from the Lamfalussy structure and explicitly recognised in Declaration 39 to the TFEU. However, the Commission has serious doubts whether the restrictions on its role when adopting delegated acts and implementing measures are in line with Articles 290 and 291 TFEU."

3.4. Explanation of the proposal

Article 1 of this proposal amends the CRA Regulation. References in the following subsections refer to the amended or new articles in the CRA Regulation, unless specified.

3.4.1. Extension of the scope of application of the Regulation to cover rating outlooks

In addition to credit ratings, CRAs also publish "rating outlooks" providing an opinion on the likely future direction of a credit rating. The Commission proposal extends the scope of the rules on credit ratings to also cover, where appropriate, "rating outlooks". The amended text requests in particular that CRAs disclose the time horizon during which a change of the credit rating is expected (cf. Annex I, Section D, Part II, point 2(f)). The CRA Regulation is therefore specifically adapted in different places: Articles 3, 6(1), 7(5), 8(2), and 10(1) and (2); in Annex I, Section B, points 1, 3, and 7; Section C, points 2, 3 and 7; Section D, Part I, points 1, 2, 4 and 5; and Section E, Part I, point 3. In addition, the amendments described below are also adapted, where appropriate, to the introduction of the "rating outlook" concept.

3.4.2. Amendments in relation to the use of credit ratings

The new Article 5a inserted in the CRA Regulation requires certain financial institutions to make their own credit risk assessment. They should therefore avoid relying solely or mechanistically on external credit ratings for assessing the creditworthiness of assets. Competent authorities should supervise the adequacy of these financial firms' credit assessment processes including monitoring that financial firms do not over-rely on credit ratings. This rule stems from the Financial Stability Board's principles for reducing reliance on CRA Ratings of October 2010.

Also, in accordance with the new Article 5b, ESMA, EBA and EIOPA should not refer to credit ratings in their guidelines, recommendations and draft technical standards where such references have the potential to trigger mechanistic reliance on credit ratings by competent authorities or financial market participants. Moreover, they should adapt their existing guidelines and recommendations accordingly, and by 31 December 2013 at the latest.

Other amendments aim at addressing the risk of over-reliance on credit ratings by financial market participants as regards structured finance instruments and at increasing the quality of the credit ratings regarding such instruments:

- Article 8a: this new article requires issuers (or originators or sponsors) to disclose specific information on structured finance products on an ongoing basis, in particular on the main elements of underlying asset pools for structured finance products

necessary for investors to make their own credit assessment and thus avoid the need to rely on external ratings. This information is to be disclosed through a centralised website operated by ESMA;

- Article 8b: this new article requires issuers (or their related third parties) who solicit a rating to engage two credit rating agencies, independent from each other, to issue two independent credit ratings in parallel on the same structured finance instruments.

Finally, it should be noted that the Commission is proposing in parallel amendments of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)¹⁰ and Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers to make sure that the principle of avoiding over-reliance on credit ratings is also integrated into the national legislation implementing those directives.

3.4.3. *Amendments in relation to the independence of CRAs*

This group of amendments establishes stricter independence rules which aim at addressing conflicts of interests with regard to the issuer-pays model and CRAs' shareholder structure:

- Article 6a: this new article prevents any member or shareholder of a CRA that holds a participation of at least 5% to hold 5% or more in any other CRA, unless the CRAs in question are members of the same group;
- Article 6b: this new article introduces a rotation rule for the CRAs engaged by the issuer (i.e. it does not apply to unsolicited ratings) to either rate the issuer itself or its debt instruments. The CRA engaged should not be in place for more than 3 years or for more than a year if it rates more than ten consecutive rated debt instruments of the issuer. However, this latter rule shall not lead to shortening the permitted period of engagement to less than a year. Where the issuer solicits more than one rating for itself or for its instrument, be it because of a legal obligation to do so or voluntarily, only one of the agencies has to rotate. However, the maximum duration for each of these CRAs is fixed at a period of six years. The former CRA (or any other CRA belonging to the same group or having shareholder links with the former CRA) should not be able to rate again the same issuer or its instruments until an appropriate cooling off period has elapsed. This article also foresees that the outgoing CRA provides the incoming CRA with a handover file including relevant information;

This rotation rule is expected to significantly mitigate the potential conflicts of interest issues relating to the issuer-pays model. Moreover, the Commission will continue to monitor the appropriateness of credit rating agencies' remuneration models and will submit a report thereon to the European Parliament and the Council by 7 December 2012, as required by Article 39 (1) of the Regulation. In this context, the Commission will also consider more far going solutions to this issue as currently assessed in other jurisdictions, including the US.

Article 6b does not apply to sovereign ratings;

¹⁰ OJ L 302, 17.11.2009, p.32.

- Annex I, Section C, point 8 in relation to Article 7(4): the rules on the internal rotation of staff within a CRA have been adapted to take account of the new Article 6b. The new rules provide that the lead rating analysts should not be involved in rating the same entity for more than 4 years, thus preventing those analysts from moving to another CRA with a client file. Rules on internal rotation rules are furthermore provided for in the case a CRA provides unsolicited ratings or sovereign ratings;
- Annex I, Section B, point 3: the Regulation would prevent a CRA from issuing credit ratings (or would require that CRA to disclose that the credit rating may be affected) where there are actual or potential conflicts of interests created by the involvement of (in addition to the CRA and its staff, already covered by the rules) persons who hold more than 10% of the capital or voting rights of the CRA, or are otherwise in a position to exercise significant influence on the business activities of the CRA, in certain situations, such as investment in the rated entity, being member of the board of the rated entity etc;
- Annex I, Section B, point 4: persons who hold more than 5% of the capital or voting rights of the CRA, or are otherwise in a position to exercise significant influence on the business activities of the CRA should not be allowed to provide consultancy or advisory services to the rated entity regarding the corporate or legal structure, assets, liabilities or activities of that rated entity.

3.4.4. *Amendments in relation to the disclosure of information on methodologies of CRAs, credit ratings and rating outlooks*

Another group of amendments strengthen the rules on the disclosure of rating methodologies, with a view to promoting sound credit rating processes and, *in fine*, improve rating quality:

- Articles 8(5a), 8(6)(aa) and 22a(3): these proposed provisions lay down procedures for the preparation of new rating methodologies or the modification of existing ones. They require the consultation of stakeholders on the new methodologies or the proposed changes and on their justification. CRAs should furthermore submit the proposed methodologies to ESMA for the assessment of their compliance with existing requirements. The new methodologies may only be used once they have been approved by ESMA. The rules also require the publication of the new methodologies together with a detailed explanation;
- Article 8(7): each CRA will be under the obligation to correct errors in its methodologies or in their application, as well as to inform ESMA, the rated entities and generally the public of such errors;
- Annex I, Section D, Part I, point 2a: the requirement to provide guidance on methodologies and underlying assumptions behind ratings is extended from structured finance products to all asset classes. The guidance provided by the CRAs should be clear and easily comprehensible.

Other disclosure obligations for CRAs are also reinforced:

- Annex I, Section D, Part I, point 3: this provision deals with the information to be provided by CRAs to issuers on the principal grounds on which the rating or an

outlook is based in advance of the publication of the rating or outlook, in order to give an opportunity to the rated entity to detect any errors in the rating. The proposed rule requires CRAs to inform issuers during the working hours of the rated entity and at least a full working day before publication. This rule applies to all ratings, whether solicited or not, and to outlooks;

- Annex I, Section D, Part I, point 6: CRAs should disclose information about all entities or debt instruments submitted to it for their initial review or for preliminary rating. Thus, the new rule extends this obligation beyond the ratings of structured finance products. This amendment entails the corresponding deletion of point 4 in Part II of Section D of Annex I.

3.4.5. Amendments in relation to sovereign ratings

Rules applying specifically to sovereign ratings (the rating of a State, a regional or local authority of a State or of an instrument for which the issuer of the debt or financial obligation is a State or a regional or local authority of a State) are particularly reinforced, with a view to improving the quality of such ratings:

- Article 8(5), new second subparagraph: CRAs are required to assess sovereign ratings more frequently: every six months instead of every twelve months;
- Annex I, Section D: a new Part III on additional obligations in relation to the presentation of sovereign ratings is added. CRAs must in particular publish a full research report when issuing and amending sovereign ratings, in order to improve transparency and enhance users' understanding. Sovereign ratings should only be published after the close of business and at least one hour before the opening of trading venues in the EU;
- Annex I, Section E, Part III, points 3 and 7: the rules on the publication of a transparency report by CRAs are strengthened by requiring CRAs to be transparent as to the allocation of staff to the ratings of different asset classes (i.e. corporate, structured finance, sovereign ratings). CRAs should also provide disaggregated data on their turnover, including data on the fees generated per different asset classes. This information should allow assessing to what extent CRAs use their resources for the issuance of sovereign ratings.

3.4.6. Amendments in relation to the comparability of credit ratings and fees for credit ratings

Enhancing competition in the credit rating market and improving ratings quality is another objective of this proposal. This objective is in particular pursued by the following amendments, which promote the comparability of credit ratings and provide for more transparency on fees charged for credit ratings:

- Article 11a: this new article require CRAs to communicate their ratings to ESMA, which would ensure that all available ratings for a debt instrument are published in the form of a European Rating Index (EURIX), freely available to investors;
- Article 21(4a): this new paragraph empowers ESMA to develop draft technical standards, for endorsement by the Commission, on a harmonised rating scale to be used by CRAs. All ratings would need to follow the same scale standards, ensuring

that ratings can be compared more easily by investors. This provision would make EURIX more useful for investors and other stakeholders;

- Annex I, Section B, point 3a: fees charged by CRAs to their clients for the provision of ratings (and ancillary services) should be non-discriminatory (i.e. based on actual cost and the transparency pricing criteria) and not based on any form of contingency (i.e. not depend on the result or outcome of the work performed). This new provision also aims at avoiding conflicts of interest (e.g. rated entities could pay higher fees in exchange of overly favourable ratings);
- Annex I, Section E, Part II, points 2(a) and 2(aa): the amended point 2(a) requires CRAs to annually disclose to ESMA a list of fees charged to each client, for individual ratings and any ancillary service. The disclosure on fees is completed by the new provision on point 7 of Part III of Section E of Annex I described above. The new point 2 (aa) requires CRAs to also disclose to ESMA their pricing policy, including pricing criteria in relation to ratings for different asset classes.

Finally, the proposed regulation requires ESMA to undertake some monitoring activities regarding market concentration (cf. Article 21(5)) and the Commission to prepare a report on this issue (Article 39(4)).

3.4.7. Amendments in relation to the civil liability of credit rating agencies vis-à-vis investors

Although this proposal for a Regulation also contains provisions aiming at reducing the risk of excessive reliance on external credit ratings (see section 3.4.2 of this explanatory memorandum), credit ratings, whether issued for regulatory purposes or not, will in the foreseeable future continue to have an impact on investment decisions. Hence, CRAs have an important responsibility towards investors in ensuring compliance with the rules of the CRA Regulation. This is reflected in the proposed Article 35a of the CRA Regulation which will render a CRA liable in case it infringes, intentionally or with gross negligence, the CRA Regulation, thereby causing damage to an investor having relied on a credit rating of such CRA, provided the infringement in question affected the credit rating.

3.4.8. Other amendments

The text of the Regulation is also adapted to clarify some obligations with regard to "certified" CRAs established in third countries. Thus, Articles 5(8), 11(2), 19(1) and 21(4)(e) of the CRA Regulation are amended accordingly.

The list of infringements in Annex III and Article 36a(2) of the CRA Regulation have also been adapted following the other changes to the Regulation.

In order to bring the CRA Regulation in line with the terminology of the Lisbon Treaty, references to the "Community" are replaced by references to the "Union".

3.4.9 The question of the European Rating Agency

This proposal is not aimed at setting up a European credit rating agency. As requested by the European Parliament in its report on credit rating agencies of 8 June 2011 this option was assessed in detail in the impact assessment accompanying this proposal. The impact assessment found that even if a publicly funded CRA may have some benefits it terms of

increasing the diversity of opinions in the rating market and providing an alternative to the issuer pays model, it would be difficult to address concerns relating to conflicts of interest and its credibility, especially if such CRA would rate sovereign debt. However, these findings should by no means discourage other actors from setting up new credit rating agencies. The Commission will monitor to what extent new private entrants in the credit rating market will provide for more diversity.

A number of measures in the current proposal should contribute to more diversity and choice in the credit rating industry:

- the proposed rotation rule will require regular changes of credit rating agencies which should open up the CRA market for new entrants; and
- the proposed prohibition for large credit rating agencies to acquire other CRAs over a period of ten years.

The Commission is also exploring ways whether and to what extent Union funds could be used to promote the creation of networks of smaller CRAs which would allow them to pool resources and generate efficiencies of scale.

4. BUDGETARY IMPLICATION

The Commission's proposal has no impact on the European Union budget. In particular, tasks that would be entrusted to ESMA as mentioned in the proposal would not entail additional EU funding.

It should also be noted that Article 19 of the CRA Regulation¹¹ provides that ESMA's expenditure necessary for the registration and supervision of CRAs according to the Regulation shall be fully covered by fees charged to the credit rating agencies.

¹¹ “1. ESMA shall charge fees to the credit rating agencies in accordance with this Regulation and the regulation on fees referred to in paragraph.
2. Those fees shall fully cover ESMA's necessary expenditure relating to the registration and supervision of credit rating agencies and the reimbursement of any costs that the competent authorities may incur carrying out work pursuant to this Regulation, in particular as a result of any delegation of tasks in accordance with Article 30.”

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

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

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national Parliaments,

Having regard to the opinion of the European Central Bank¹,

Having regard to the opinion of the European Economic and Social Committee²,

Acting in accordance with the ordinary legislative procedure,

Whereas:

- (1) Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies³ requires credit rating agencies to comply with rules of conduct in order to mitigate possible conflicts of interest, ensure high quality and sufficient transparency of ratings and the rating process. Following the amendments introduced by Regulation (EU) No 513/2011 of the European Parliament and of the Council⁴, the European Securities and Markets Authority (ESMA) has been empowered to register and supervise credit rating agencies. This amendment complements the current regulatory framework for credit rating agencies. Some of the issues addressed (conflicts of interests due to the issuer-pays model, disclosure for structured finance instruments) had been identified, but not fully resolved by the existing rules. The need to review transparency and procedural requirements specifically for sovereign ratings was highlighted by the current sovereign debt crisis.

¹ OJ C , , p.

² OJ C , , p.

³ OJ L 302, 17.11.2009, p.1.

⁴ OJ L 145, 31.5.2011, p.30.

- (2) The European Parliament issued a resolution on credit ratings agencies on 8 June 2011 calling for enhanced regulation on credit rating agencies⁵. At an informal ECOFIN meeting of September 30 and October 1, 2010, the Council of the European Union acknowledged that further efforts should be made to address a number of issues related to credit rating activities, including the risk of over-reliance on credit ratings and the risk of conflict of interests stemming from the remuneration model of rating agencies. The European Council of 23 October 2011 concluded that progress is needed on reducing overreliance on credit ratings.
- (3) At the international level the Financial Stability Board (FSB) endorsed on 20 October 2010 principles to reduce authorities' and financial institutions' reliance on CRA ratings. Those principles were endorsed by the G20 Seoul Summit in November 2010.
- (4) The relevance of rating outlooks for investors and issuers and their effects on markets are comparable to the relevance and effects of credit ratings. Therefore, all the requirements of Regulation (EC) No 1060/2009 which aim at ensuring that rating actions are free from conflicts of interest, accurate and transparent should also apply to rating outlooks. According to current supervisory practice a number of requirements of the Regulation apply to rating outlooks. This Regulation introduces a definition of rating outlooks and clarifies which specific provisions apply to such outlooks. This should clarify the rules and provide legal certainty. The definition of rating outlooks according to this Regulation should also encompass opinions regarding the likely direction of a credit rating in the short term, commonly referred to as credit watches.
- (5) Credit rating agencies are important participants in the financial markets. As a consequence, the independence and integrity of credit rating agencies and their credit rating activities are of particular importance to guarantee their credibility vis-à-vis market participants, in particular investors and other users of ratings. Regulation 1060/2009 provides that credit rating agencies have to be registered and supervised as their services have considerable impact on the public interest. Credit ratings, unlike investment research, are not mere opinions about a value or a price for a financial instrument or a financial obligation. Credit rating agencies are not mere financial analysts or investment advisors. Credit ratings have regulatory value for regulated investors, such as credit institutions, insurance companies and other institutional investors. Although the incentives to excessively rely on credit ratings are being reduced, credit ratings still drive investment choices, notably because of information asymmetries and for efficiency purposes. In this context, credit rating agencies must be independent and perceived as such by market participants.
- (6) Regulation (EC) No 1060/2009 already provided a first round of measures to address the question of independence and integrity of credit rating agencies and their credit rating activities. The objectives of guaranteeing the independence of credit rating agencies and of identifying, managing and, to the extent possible, avoiding any conflict of interest that could arise were already underlying several provisions of that Regulation in 2009. Whilst providing a sound basis, the existing rules do not appear to have had a sufficient impact in this regard. Credit rating agencies still are not perceived as sufficiently independent actors. The selection and remuneration of the

⁵ 2010/2302/INI.

credit rating agency by the rated entity (issuer-pays model) engenders inherent conflicts of interest, which are insufficiently addressed by the existing rules. Under this model, there are incentives for credit rating agencies to issue complacency ratings on the issuer in order to secure a long-standing business relationship guaranteeing revenues or in order to secure additional work and revenues. Moreover, relationships between the shareholders of credit rating agencies and the rated entities may cause conflicts of interest which are not sufficiently dealt with by the existing rules. As a result, credit ratings issued under the issuer-pays model may be perceived as the credit ratings that suit the issuer rather than the credit ratings needed by the investor. Without prejudice to the conclusions of the report to be submitted by the Commission on the issuer-pays model by December 2012 pursuant to Article 39(1) of Regulation (EC) No 1060/2009, it is essential to reinforce the conditions of independence applying to credit rating agencies in order to increase the level of credibility of credit ratings issued under the issuer-pays model.

- (7) The credit rating market shows that, traditionally, credit rating agencies and rated entities enter into long-lasting relationships. This raises the threat of familiarity, as the credit rating agency may become too sympathetic to the desires of the rated entity. In those circumstances, the impartiality of credit rating agencies over time could become questionable. Indeed, credit rating agencies mandated and paid by a corporate issuer are incentivised to issue overly favourable ratings on that rated entity or its debt instruments in order to maintain the business relationship with such issuer. Issuers are also subject to incentives that favour long-lasting relationships, such as the lock-in effect: an issuer may refrain from changing credit rating agency as this may raise concerns of investors regarding the issuer's creditworthiness. This problem was already identified in Regulation (EC) No 1060/2009, which required credit rating agencies to apply a rotation mechanism providing for gradual changes in analytical teams and credit rating committees so that the independence of the rating analysts and persons approving credit ratings would not be compromised. The success of those rules, however, was highly dependant on a behavioural solution internal to the credit rating agency: the actual independence and professionalism of the employees of the credit rating agency vis-à-vis the commercial interests of the credit rating agency itself. These rules were not designed to provide sufficient guarantee towards third parties that the conflicts of interest arising from the long-lasting relationship would effectively be mitigated or avoided. It therefore appears necessary to provide for a structural response having a higher impact on third parties. This could be achieved effectively by limiting the period during which a credit rating agency can continuously provide credit ratings on the same issuer or its debt instruments. Setting out a maximum duration of the business relationship between the issuer which is rated or which issued the rated debt instruments and the credit rating agency should remove the incentive for issuing favourable ratings on that issuer. Additionally, requiring the rotation of credit rating agencies as a normal and regular market practice should also effectively address the lock-in effect, where an issuer refrains from changing credit rating agency as this would raise concerns of investors regarding the issuer's creditworthiness. Finally, the rotation of credit rating agencies should have positive effects on the rating market as it would facilitate new market entries and offer existing credit rating agencies the opportunity to extend their business to new areas.
- (8) Regular rotation of credit rating agencies issuing credit ratings on an issuer or its debt instruments should bring more diversity to the evaluation of the creditworthiness of

the issuer that selects and pays that credit rating agency. Multiple and different views, perspectives and methodologies applied by credit rating agencies should produce more diverse credit ratings and ultimately improve the assessment of the creditworthiness of the issuers. For this diversity to play a role and to avoid complacency of both issuers and credit rating agencies, the maximum duration of the business relationship between the credit rating agency and the issuer paying must be restricted to a level guaranteeing regular fresh looks at the creditworthiness of issuers. Therefore, a time period of three years would seem appropriate, also considering the need to provide certain continuity within the credit ratings. The risk of conflict of interest increases in situations where the credit rating agency frequently issues credit ratings on debt instruments of the same issuer within a short period of time. In those cases, the maximum duration of the business relationship should be shorter to guarantee similar results. Hence, the business relationship should stop after a credit rating has rated ten debt instruments of the same issuer. However, in order to avoid imposing a disproportionate burden on issuers and credit rating agencies, no requirement to change credit rating agency within the first 12 months of the business relationship should be imposed. Where an issuer mandates more than one credit rating agency, either because as an issuer of structured finance instruments he is obliged to do so, or on a voluntary basis, it should be sufficient that the strict rotation periods only apply to one of the credit rating agencies. However, also in this case, the business relationship between the issuer and the additional credit rating agencies should not exceed a period of six years.

- (9) The rule requiring rotation of credit rating agencies needs to be enforced in a credible manner to be meaningful. The rotation rule would not achieve its objectives if the outgoing credit rating agency were allowed to provide rating services to the same issuer again within a too short period of time. Therefore, it is important to provide for an appropriate period within which such credit rating agency may not be mandated by the same issuer to provide rating services. That period should be sufficiently long to allow the incoming credit rating agency to effectively provide its rating services to the issuer, to ensure that the issuer is truly exposed to a new scrutiny under a different approach and to guarantee that the credit ratings issued by the new credit rating agency provide enough continuity. That period should allow that an issuer cannot rely on comfortable arrangements with only two credit rating agencies that would replace each other on a continuous basis, as this could lead to maintaining the familiarity threat. Hence, the period during which the outgoing credit rating agency should not provide rating services to the issuer should generally be set at four years.
- (10) The change of credit rating agency inevitably increases the risk that knowledge about the rated entity acquired by the outgoing rating agency is lost. As a result, the incoming credit rating agency would have to make considerable efforts to acquire the knowledge necessary to carry out its work. However, a smooth transition should be ensured by establishing a requirement on the outgoing credit rating agency to transfer relevant information on the rated entity or instruments to the incoming credit rating agency.
- (11) Requiring issuers to regularly change the credit rating agency they mandate to issue credit ratings is proportionate to the objective pursued. This requirement only applies to certain regulated institutions (registered credit rating agencies) which provide a service affecting the public interest (credit ratings that can be used for regulatory purposes) under certain conditions (issuer-pays model). The privilege of having its services recognised as playing an important role in the regulation of the financial

services market and being approved to carry out this function, entails the need to respect certain obligations in order to guarantee independence and the perception of independence in all circumstances. A credit rating agency which is prevented from providing credit rating services to a particular issuer would still be allowed to provide credit ratings to other issuers. In a market context where the rotation rule applies to all players, business opportunities will arise since all issuers would need to change credit rating agency. Moreover, credit rating agencies may always issue unsolicited credit ratings on the same issuer, capitalising on their experience. Unsolicited ratings are not constrained by the issuer-pays model and therefore are less affected by potential conflicts of interests. For issuers, the maximum duration of the business relationship with a credit rating agency or the rule on the employment of more than one credit rating agency also represents a restriction on their freedom to conduct their own business. However, this restriction is necessary on public-interest grounds considering the interference of the issuer-pays model with the necessary independence of credit rating agencies to guarantee independent credit ratings that can be used by investors for regulatory purposes. At the same time, these restrictions do not go beyond what is necessary and should rather be seen as an element increasing the issuer's creditworthiness towards other parties, and ultimately the market.

- (12) One of the specificities of sovereign ratings is that the issuer-pays model generally does not apply. Instead, the majority of ratings are produced as unsolicited ratings, providing the basis for both solicited and unsolicited ratings of the financial institutions of the country concerned. It is therefore not necessary to require the rotation of credit rating agencies issuing sovereign ratings.
- (13) The independence of a credit rating agency vis-à-vis a rated entity is also affected by possible conflict of interests of any of its significant shareholders with the rated entity: A shareholder of a credit rating agency could be a member of the administrative or supervisory board of a rated entity or a related third party. The rules of Regulation (EC) No 1060/2009 addressed this type of situation only as regards the conflicts of interest caused by rating analysts, persons approving the credit ratings or other employees of the credit rating agency. The Regulation was, however, silent as regards potential conflicts of interest caused by shareholders or members of credit rating agencies. With a view to enhancing the perception of independence of credit rating agencies vis-à-vis the rated entities, it is appropriate to extend the existing rules applying to conflicts of interest caused by employees of the credit rating agencies also to those caused by shareholders or members holding a significant position within the credit rating agency. Hence, the credit rating agency should abstain from issuing credit ratings, or should disclose that the credit rating may be affected, where a shareholder or member holding 10% of the voting rights of that agency is also a member of the administrative or supervisory board of the rated entity or has invested in the rated entity. Moreover, where a shareholder or member is in a position to significantly influence the business activity of the credit rating agency, that person should not provide consultancy or advisory services to the rated entity or a related third party regarding its corporate or legal structure, assets, liabilities or activities.
- (14) The rules on independence and prevention of conflicts of interest, could become ineffective if credit rating agencies were not independent from each other. A sufficiently high number of credit rating agencies, unconnected with both the outgoing credit rating agency in case of rotation and with the credit rating agency providing credit rating services in parallel to the same issuer, is necessary for a workable

application of those rules. In the absence of sufficient choice of credit rating agencies for the issuer in the current market, the implementation of these rules aimed at enhancing independence conditions would risk becoming ineffective. Therefore, it is appropriate to require a strict separation of the outgoing agency from the incoming credit rating agency in case of rotation as well as of the two credit rating agencies providing rating services in parallel to the same issuer. The credit rating agencies concerned should not be linked to each other by control, by being part of the same group of credit rating agencies, by being shareholder or member of or being able to exercise voting rights in any of the other agencies, or by being able to appoint members of the administrative, management or supervisory boards of any of the other credit rating agencies.

- (15) The perception of independence of credit rating agencies would be particularly affected should the same shareholders or members be investing in different credit rating agencies not belonging to the same group of credit rating agencies, at least if this investment reaches a certain size that could allow these shareholders or members to exercise a certain influence on the agency's business. Therefore, in order to ensure the independence (and the perception of independence) of credit rating agencies, it is appropriate to provide for stricter rules regarding the relations between the credit rating agencies and their shareholders. For this reason, no person should simultaneously hold a participation of 5% or more in more than one credit rating agency, unless the agencies concerned belong to the same group.
- (16) The objective of ensuring sufficient independence of credit rating agencies entails that investors should not hold simultaneously investments of 5 % or more in more than one credit rating agency. Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market⁶ requests that those persons controlling 5% of the voting rights in a listed company results should disclose it to the public, because, *inter alia*, of the interest for investors to know about changes in the voting structure of such company. 5% of the voting rights is considered therefore to be a major holding capable of influencing the voting structure in a company. It is therefore appropriate to use the 5% level for the purposes of restricting the simultaneous investment in more than one credit rating agency. This measure cannot be considered disproportionate, given that all registered credit rating agencies in the Union are non-listed undertakings therefore not subject to the transparency and procedural rules that apply to listed companies in the EU. Often unlisted undertakings are governed by shareholders' protocols or agreements and the number of shareholders or members is usually low. Therefore, even a minority position in an unlisted credit rating agency could be influential. Nevertheless, in order to ensure that purely economic investments in credit rating agencies are still possible, this limitation to simultaneously investments in more than one credit rating agency should not be extended to investments channelled through collective investment schemes managed by third parties independent from the investor and not subject to his or her influence.
- (17) The new rules limiting the duration of the business relationship between an issuer and the credit rating agency would significantly reshape the credit rating market in the

⁶ OJ L 390, 31.12.2004, p.38.

Union, which today remains largely concentrated. New market opportunities would arise for small and mid-size credit rating agencies, which would need to develop to take up those challenges in the first years following the entry into force of the new rules. Those developments are likely to bring new diversity into the market. The objectives and the effectiveness of the new rules would, however, be largely jeopardised if, during these initial years, large established credit rating agencies would prevent their competitors from developing credible alternatives by acquiring them. Further consolidation in the credit rating market driven by large established players would result in a reduction of the number of available registered credit rating agencies, thus creating selection difficulties for issuers at the moment in which they regularly need to appoint one or more new credit rating agencies and disturbing the smooth functioning of the new rules. More importantly, further consolidation driven by large established credit rating agencies would particularly prevent the emergence of more diversity in the market.

- (18) The effectiveness of the rules on independence and prevention of conflict of interest which require that credit rating agencies should not provide for a long period of time credit rating services to the same issuer could be undermined if credit rating agencies were allowed to become directly or indirectly shareholders or members of other credit rating agencies.

- (19) It is important to ensure that modifications to the rating methodologies do not result in less rigorous methodologies. For that purpose, issuers, investors and other interested parties should have the opportunity to comment on any intended change of rating methodologies. This will help them to understand the reasons behind new methodologies and for the change in question. Comments provided by issuers and investors on the draft methodologies may provide valuable input for the credit rating agencies in defining the methodologies. Moreover, ESMA should verify and confirm the compliance of new rating methodologies with Article 8(3) of Regulation (EC) No 1060/2009 and the relevant regulatory technical standard before methodologies are applied in practice. ESMA should verify that the proposed methodologies are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing. However, this verification process should not grant ESMA any power to judge the appropriateness of the proposed methodology or the content of the credit ratings issued following the application of the methodologies.

- (20) Due to the complexity of structured finance instruments, credit rating agencies have not always succeeded in ensuring a sufficiently high quality of credit ratings issued on such instruments. This has led to a loss of market confidence in this type of credit ratings. In order to regain confidence it would be appropriate to require issuers or their related third parties to engage two different credit rating agencies for the provision of credit ratings on structured finance instruments, which could lead to different and competing assessments. This could also reduce the over-reliance on a single credit rating.

- (21) Directive xxxx/xx/EU of the European Parliament and of the Council of [...] on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms⁷ has introduced a provision requiring banks and

⁷ OJ C , , p.

investment firms to assess the credit risk of entities and financial instruments in which they invest themselves and not to simply rely in this respect on external ratings. This rule should be extended to other financial firms regulated under Union law, including investment managers. Member States should not be entitled to impose rules that allow stricter reliance of these investors on external ratings.

- (22) Furthermore, the investors' possibilities to make an informed assessment of the credit worthiness of structured finance instruments would be improved if investors were provided with sufficient information on these instruments. This will reduce investors' dependence on credit ratings. Moreover, disclosing relevant information on structured finance instruments is likely to reinforce the competition between credit rating agencies, because it could lead to an increase in the number of unsolicited ratings.
- (23) Investors, issuers and other interested parties should have access to up to date rating information on a central webpage. A European Rating Index (EURIX) established by ESMA should allow investors to easily compare all ratings that exist with regard to a specific rated entity and provide them with average ratings. In order to enable investors to compare ratings on the same entity issued by different credit rating agencies it is necessary that credit rating agencies use a harmonised rating scale, to be developed by ESMA and adopted by the Commission as a regulatory technical standard. The use of the harmonised rating scale should only be mandatory for the publication of the ratings on the EURIX webpage while credit rating agencies should be free to use their own rating scales when publishing the ratings on their own websites. The mandatory use of a harmonised rating scale should not have a harmonising effect on methodologies and processes of credit rating agencies, but should be limited to making the rating outcome comparable. It is important that the EURIX webpage shows, in addition to an aggregate rating index, all available ratings per instrument in order to allow investors to consider the whole variety of opinions before taking their own investment decision. The aggregate rating index may help investors to get a first indication of the creditworthiness of an entity. The EURIX should help smaller and new credit rating agencies to gain visibility. The European Rating Index would complement the information on historical performance data to be published by credit rating agencies in ESMA's central repository. The European Parliament supported the establishment of such European Rating Index in its resolution on credit rating agencies of 8 June 2011⁸.
- (24) Credit ratings, whether issued for regulatory purposes or not, have a significant impact on investment decisions. Hence, credit rating agencies have an important responsibility towards investors in ensuring that they comply with the rules of Regulation (EC) No 1060/2009 so that their ratings are independent, objective and of adequate quality. However, in the absence of a contractual relationship between the credit rating agency and the investor, investors are not always in a position to enforce the agency's responsibility towards them. Therefore, it is important to provide for an adequate right of redress for investors who relied on a credit rating issued in breach of the rules of Regulation (EC) No 1060/2009. The investor should be able to hold the credit rating agency liable for any damage caused by an infringement of that Regulation which had an impact on the rating outcome. Infringements which do not

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impact the rating outcome, such as breaches of transparency obligations, should not trigger civil liability claims.

- (25) Credit rating agencies should only be held liable if they infringe intentionally or with gross negligence any obligations imposed on them by Regulation (EC) No 1060/2009. This standard of fault means that credit rating agencies should not face liability claims if they neglect individual obligations under the Regulation without disregarding their duties in a serious way. This standard of fault is appropriate because the activity of credit rating involves a certain degree of assessment of complex economic factors and the application of different methodologies may lead to different rating results, non of which can be qualified as incorrect.
- (26) It is important to provide investors with an effective right of redress against credit rating agencies. As investors do not have close insight in internal procedures of credit rating agencies a partial reversal of the burden of proof with regard to the existence of an infringement and the infringement's impact on the rating outcome seems to be appropriate if the investor has made a reasonable case in favour of the existence of such an infringement. However, the burden of proof as regards the existence of a damage and the causality of the infringement for the damage, both being closer to the sphere of the investor, should fully be on the investor.
- (27) Regarding matters concerning the civil liability of a credit rating agency and which are not covered by this regulation, such matters should be governed by the applicable national law determined by the relevant rules of International Private Law. The competent court to decide on a claim for civil liability brought by an investor should be determined by the relevant rules on International Jurisdiction.
- (28) The fact that institutional investors including investment managers are obliged to carry out their own assessment of the creditworthiness of assets should not prevent courts from finding that an infringement of this Regulation by a credit rating agency has caused damage to an investor for which that credit rating agency is liable. While this Regulation will improve the possibilities of investors to make an own risk assessment they will continue to have more limited access to information than the credit agencies themselves. Furthermore, in particular smaller investors often will lack the capability to critically review an external rating provided by a credit rating agency.
- (29) In order to further mitigate conflicts of interest and facilitate fair competition in the credit rating market, it is important to ensure that the fees charged by credit rating agencies to customers are not discriminatory. Differences in fees charged for the same type of service should only be justifiable by a difference in the actual costs in providing this service to different customers. Moreover, the fees charged for rating services to a given issuer should not depend on the results or outcome of the work performed or on the provision of related (ancillary) services. Furthermore, in order to allow for the effective supervision of those rules, credit rating agencies should disclose to ESMA the fees received from each of their clients and their general pricing policy.
- (30) In order to contribute to the issuance of up to date and credible sovereign ratings and to facilitate users' understanding, it is important to regularly review ratings. It is also important to increase the transparency about the research work carried out, the staff allocated to the preparation of ratings and the underlying assumptions behind the credit ratings made by credit rating agencies in relation to sovereign debt.

- (31) The current rules already provide for ratings to be announced to the rated entity 12 hours before their publication. In order to avoid that this notification takes place outside working hours and to leave the rated entity sufficient time to verify the correctness of data underlying the rating, it should be clarified that the rated entity should be notified a full working day before publication of the rating or of a rating outlook.
- (32) In view of the specificities of sovereign ratings and in order to reduce the risk of volatility, it is appropriate to require credit rating agencies to only publish these ratings after the close of business of the trading venues established in the Union and at least one hour before their opening.
- (33) Technical standards in financial services should ensure and adequate protection of depositors, investors and consumers across the Union. As a body with highly specialised expertise, it would be efficient and appropriate to entrust ESMA, with the elaboration of draft regulatory and implementing technical standards which do not involve policy choices, for submission to the Commission.
- (34) The Commission should adopt the draft regulatory technical standards developed by ESMA regarding the content of the handover file when a credit rating agency is replaced by another credit rating agency, the content, frequency and presentation of the information to be provided by issuers on structured finance instruments, harmonisation of the standard rating scale to be used by credit rating agencies, the presentation of the information, including structure, format, method and timing of reporting, that credit rating agencies should disclose to ESMA in relation to EURIX and the content and format of the periodic reporting on fees charged by credit rating agencies for the purposes of ongoing supervision by ESMA. The Commission should adopt those standards by means of delegated acts pursuant to Article 290 of the Treaty and in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.
- (35) Regulation (EU) No 1060/2009 allows ratings issued in third countries to be used for regulatory purposes if they are issued by credit rating agencies certified in accordance with Article 5 or endorsed by credit rating agencies established in the Union in accordance with Article 4 (3) of that Regulation. Certification requires that the Commission has adopted an equivalence decision regarding the third country's regulatory regime for credit rating agencies and endorsement requires that the conduct of the third country credit rating agency fulfils requirements which are at least as stringent as the relevant EU rules. Some of the provisions introduced by this Regulation should not apply for the equivalence and endorsement assessments: This is the case for those provisions that only establish obligations on issuers but not on credit rating agencies. In addition, articles that relate to the structure of the rating market within the EU rather than establishing rules of conduct for credit rating agencies should not be considered in this context.. In order to grant third countries sufficient time to upgrade their regulatory frameworks regarding the remaining new substantive provisions, the latter should only apply for the purpose of the equivalence and endorsement assessments as of 1 June 2014. It is important to recall in this respect that a third country regulatory regime does not have to have identical rules as those provided for in this Regulation. As already spelled out in Regulation No 1060/2009, in order to be considered equivalent to or as stringent as the EU regulatory regime it should be sufficient that the third country regulatory regime achieves the same objectives and effects in practice.

(36) Since the objectives of this Regulation, namely to reinforce the independence of credit rating agencies, to promote sound credit rating processes and methodologies, to mitigate the risks associated to sovereign ratings, to reduce the risk of over-reliance on credit ratings by market participants, and to ensure a right of redress for investors, cannot be sufficiently achieved at the Member State level and can therefore, by reason of the pan-Union structure and impact of the credit rating activities to be supervised, be better achieved at the Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Regulation does not go beyond what is necessary in order to achieve those objectives.

(37) Regulation (EC) No 1060/2009 should therefore be amended accordingly,

HAVE ADOPTED THIS REGULATION:

Article 1
Amendments to Regulation (EC) No 1060/2009

Regulation (EC) No 1060/2009 is amended as follows:

(1) Article 1 is replaced by the following:

"Article 1

Subject matter

This Regulation introduces a common regulatory approach in order to enhance the integrity, transparency, responsibility, good governance and reliability of credit rating activities, contributing to the quality of credit ratings issued in the Union, thereby contributing to the smooth functioning of the internal market while achieving a high level of consumer and investor protection. It lays down conditions for the issuing of credit ratings and rules on the organisation and conduct of credit rating agencies, including their shareholders and members, to promote credit rating agencies' independence, the avoidance of conflicts of interest and the enhancement of consumer and investor protection.

This Regulation also lays down obligations for issuers, originators and sponsors established in the Union regarding structured finance instruments."

(2) in the first paragraph of Article 2, "Community" is replaced by "Union";

(3) Article 3(1) is amended as follows:

(a) in point (g), "Community" is replaced by "Union";

(b) in point (m), "Community" is replaced by "Union";

(c) the following points are added:

- '(s) "issuer" means issuer as defined in point (h) of Article 2 (1) of Directive 2003/71/EC;
- (t) "originator" means originator as defined in point (41) of Article 4 of Directive 2006/48/EC;
- (u) "sponsor" means a sponsor as defined in point (42) of Article 4 of Directive 2006/48/EC;
- (v) "sovereign rating" means:
 - (i) a credit rating where the entity rated is a State or a regional or local authority of a State,
 - (ii) a credit rating where the issuer of the debt or financial obligation, debt security or other financial instrument is a State or a regional or local authority of a State;
- (w) "rating outlook" means an opinion regarding the likely direction of a credit rating over the short and medium term.';

(4) Article 4 is amended as follows:

- (a) in the second subparagraph of paragraph 1, "Community" is replaced by "Union";
- (b) in paragraph 2, "Community" is replaced by "Union";
- (c) paragraph 3 is amended as follows:
 - (i) in the introductory sentence, "Community" is replaced by "Union";
 - (ii) point (b) is replaced by the following:

'the credit rating agency has verified and is able to demonstrate on an ongoing basis to the European Supervisory Authority (European Securities and Markets Authority) established by Regulation (EU) No 1095/1060 of the European Parliament and of the Council (*) (ESMA), that the conduct of the credit rating activities by the third-country credit rating agency resulting in the issuing of the credit rating to be endorsed fulfils requirements which are at least as stringent as the requirements set out in Articles 6 to 12, with the exception of Articles 6a, 8a, 8b and 11a.

(*) OJ L 331, 15.12.2010, p.84.';

- (d) in paragraph 4, "Community" is replaced by "Union";

(5) Article 5 is amended as follows:

- (a) in paragraph 1, "Community" is replaced by "Union";
- (b) in paragraph 6, point (b) of the second subparagraph is replaced by the following:

'(b) credit rating agencies in that third country are subject to legally binding rules which are equivalent to those set out in Articles 6 to 12 and Annex I, with the exception of Articles 6a, 8a, 8b and 11a; and';

(c) paragraph 8 is replaced by the following:

'Articles 20, 23b and 24 shall apply to certified credit rating agencies and to credit ratings issued by them.';

(6) the following Articles 5a and 5b are inserted:

"Article 5a

Over-reliance on credit ratings by financial institutions

Credit institutions, investment firms, insurance and reinsurance undertakings, institutions for occupational retirement provisions, management and investment companies, alternative investment fund managers and central counterparties as defined in Regulation (EU) No xx/201x of the European Parliament and of the Council of xx xxx 201x on OTC derivatives, central counterparties and trade repositories⁹ shall make their own credit risk assessment and shall not solely or mechanistically rely on credit ratings for assessing the creditworthiness of an entity or financial instrument. Competent authorities in charge of supervising these undertakings shall closely check the adequacy of undertakings credit assessment processes.

Article 5b

Reliance on credit ratings by the European Supervisory Authorities and the European Systemic Risk Board

The European Supervisory Authority (European Banking Authority) established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council (*) (EBA), the European Supervisory Authority (European Insurance and Occupational Pensions Authority) established by Regulation (EU) No 1094/2010 of the European Parliament and of the Council (**) (EIOPA) and ESMA shall not refer to credit ratings in their guidelines, recommendations and draft technical standards where such references have the potential to trigger mechanistic reliance on credit ratings by competent authorities or financial market participants. Accordingly, and at the latest by 31 December 2013, EBA, EIOPA and ESMA shall review and remove where appropriate all references to credit ratings in existing guidelines and recommendations.

The European Systemic Risk Board (ESRB) established by Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (***) shall not refer to credit ratings in its warnings and recommendations where such references have the potential to trigger mechanistic reliance on credit ratings.

⁹ OJ L ... , p.

* OJ L , , p. .

** OJ L 331, 15.12.2010, p.48.

*** OJ L 331, 15.12.2010, p. 1.';

(7) Article 6(1) is replaced by the following:

'1. A credit rating agency shall take all necessary steps to ensure that the issuing of a credit rating or a rating outlook is not affected by any existing or potential conflict of interest or business relationship involving the credit rating agency issuing the credit rating or the rating outlook, its managers, rating analysts, employees, any other natural person whose services are placed at the disposal or under the control of the credit rating agency, or any person directly or indirectly linked to it by control.';

(8) the following Articles 6a and 6b are inserted:

'Article 6a

Conflicts of interest concerning investments in credit rating agencies

1. A shareholder or a member of a credit rating agency holding at least 5% of the capital or the voting rights in that agency shall not

- (a) hold 5% or more of the capital of any other credit rating agency. This prohibition does not apply to holdings in diversified collective investment schemes, including managed funds such as pension funds or life insurance, provided that the holdings in diversified collective investment schemes do not put him or her in a position to exercise significant influence on the business activities of those schemes;
- (b) have the right or the power to exercise 5% or more of the voting rights in any other credit rating agency;
- (c) have the right or the power to appoint or remove members of the administrative, management or supervisory body of any other credit rating agency;
- (d) be member of the administrative, management or supervisory body of any other credit rating agency;
- (e) have the power to exercise, or actually exercise, dominant influence or control over any other credit rating agency.

2. This Article does not apply to investments in other credit rating agencies belonging to the same group of credit rating agencies.

Article 6b

Maximum duration of the contractual relationship with a credit rating agency

1. Where a credit rating agency has entered into a contract with an issuer or its related third party for the issuing of credit ratings on that issuer, it shall not issue credit ratings on that issuer for a period exceeding three years.

2. Where a credit rating agency has entered into a contract with an issuer or its related third party for the issuing of credit ratings on the debt instruments of that issuer, the following shall apply:

- (a) when those credit ratings are issued within a period exceeding an initial period of twelve months but shorter than three years, the credit rating agency shall not issue any further credit ratings on those debt instruments from the moment that ten debt instruments have been rated;
- (b) when at least ten credit ratings are issued within an initial period of twelve months, that credit rating agency shall not issue any further credit ratings on those debt instruments after the end of that period;
- (c) when less than ten credit ratings are issued, the credit rating agency shall not issue any further credit ratings on those debt instruments from the moment a period of 3 years have elapsed.

3. Where an issuer has entered into a contract regarding the same matter with more than one credit rating agency, the limitations set out in paragraphs 1 and 2 shall only apply to one of these agencies. However, none of these agencies shall have a contractual relationship with the issuer exceeding a period of six years.

4. The credit rating agency referred to in paragraphs 1 to 3 shall not enter into a contract with the issuer or its related third parties for the issuing of credit ratings on the issuer or its debt instruments for a period of four years from the end of the maximum duration period of the contractual relationship referred to in paragraphs 1 to 3.

The first subparagraph shall also apply to:

- (a) a credit rating agency belonging to the same group of credit rating agencies as the credit rating agency referred to in paragraphs 1 and 2;
- (b) a credit rating agency which is a shareholder or member of the credit rating agency referred to in paragraphs 1 and 2;
- (c) a credit rating agency in which the credit rating agency referred to in paragraph 1 and 2 is a shareholder or member.

5. Paragraphs 1 to 4 shall not apply to sovereign ratings.

6. Where following the end of the maximum duration period of the contractual relationship, pursuant to the rules in paragraphs 1 and 2, a credit rating agency is replaced by another credit rating agency, the exiting credit rating agency shall provide the incoming credit rating agency with a handover file. Such file shall include relevant information concerning the rated entity and the rated debt instruments as may reasonably be necessary to ensure the comparability with the ratings carried out by the exiting credit rating agency.

The exiting rating agency shall be able to demonstrate to ESMA that such information has been provided to the incoming credit rating agency.

7. ESMA shall develop draft regulatory technical standards to specify technical requirements on the content of the handover file referred to in paragraph 5.

ESMA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in this paragraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1095/2010.

(9) Article 7(5) is replaced by the following:

'5. Compensation and performance evaluation of rating analysts and persons approving the credit ratings or rating outlooks shall not be contingent on the amount of revenue that the credit rating agency derives from the rated entities or related third parties.';

(10) Article 8 is amended as follows:

(a) paragraph 2 is replaced by the following:

'2. A credit rating agency shall adopt, implement and enforce adequate measures to ensure that the credit ratings and the rating outlooks it issues are based on a thorough analysis of all the information that is available to it and that is relevant to its analysis according to the applicable rating methodologies. It shall adopt all necessary measures so that the information it uses in assigning credit ratings and rating outlooks is of sufficient quality and from reliable sources.';

(b) in paragraph 5, a second subparagraph is added:

'Sovereign ratings shall be reviewed at least every six months.';

(c) the following paragraph 5a is inserted:

'5a. A credit rating agency that intends to change or use any new rating methodologies, models or key rating assumptions shall publish the proposed changes or proposed new methodologies on its website inviting stakeholders to submit comments for a period not shorter than one month, together with a detailed explanation of the reasons for and the implications of the proposed changes or proposed new methodologies.

After expiry of the consultation period referred to in the first subparagraph, the credit rating agency shall notify ESMA of the intended changes or proposed new methodologies.';

(d) paragraph 6 is amended as follows:

(i) the introductory sentence is replaced by the following:

'6. When methodologies, models or key assumptions used in credit rating activities are changed following the decision of ESMA referred to in paragraph 3 of Article 22a, a credit rating agency shall:';

(ii) the following point (aa) is inserted:

'(aa) immediately publish on its website the new methodologies together with a detailed explanation thereof;';

(e) the following paragraph 7 is added:

'7. Where a credit rating agency becomes aware of errors in its methodologies or in their application it shall immediately:

(a) notify those errors to ESMA and all affected rated entities;

(b) publish those errors on its website;

(c) correct those errors in the methodologies; and

(d) apply the measures referred to in points (a) to (c) of paragraph 6.';

(11) the following Articles 8a and 8b are inserted:

'Article 8a

Information on structured finance instruments

1. The issuer, the originator and the sponsor of a structured finance instrument established in the Union shall disclose to the public, in accordance with paragraph 4, information on the credit quality and performance of the individual underlying assets of the structured finance instrument, the structure of the securitization transaction, the cash flows and any collateral supporting a securitisation exposure as well as any information that is necessary to conduct comprehensive and well informed stress tests on the cash flows and collateral values supporting the underlying exposures.

2. The obligation to disclose information according to paragraph 1 shall not extend to the provision of such information that would breach statutory provisions governing the protection of confidentiality of information sources or the processing of personal data.

3. ESMA shall develop draft regulatory technical standards to specify:

(a) the information that the persons referred to in paragraph 1 shall disclose in order to comply with the obligation resulting from paragraph 1;

(b) the frequency with which such information shall be updated;

(c) the presentation of the information by means of a standardised disclosure template.

ESMA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1095/2010.

4. ESMA shall set up a webpage for the publication of the information on structured finance instruments in accordance with paragraph 1.

Article 8b

Double credit rating of structured finance instruments

1. Where an issuer or a related third party intends to solicit a credit rating of a structured finance instrument, it shall mandate at least two credit rating agencies. Each credit rating agency shall provide its own independent credit rating.

2. The credit rating agencies mandated by an issuer or its related third parties referred in paragraph 1 shall comply with the following conditions:

- (a) the credit rating agencies shall not belong to the same group of credit rating agencies;
- (b) none of the credit rating agencies shall be a shareholder or member of any of the other credit rating agencies;
- (c) none of the credit rating agencies shall have the right or the power to exercise voting rights in any of the other credit rating agencies;
- (d) none of the credit rating agencies shall have the right or the power to appoint or remove members of the administrative, management or supervisory body of any of the other credit rating agencies;
- (e) none of the members of the administrative, management or supervisory body in a credit rating agency is a member of the of the administrative, management or supervisory body of any of the other credit rating agencies;
- (f) none of the credit rating agencies shall have the power to exercise, or actually exercises, dominant influence or control over any of the other credit rating agencies.';

(12) Article 10(1) and (2) are replaced by the following:

'1. A credit rating agency shall disclose any credit rating or rating outlook, as well as any decision to discontinue a credit rating, on a non-selective basis and in a timely manner. In the event of a decision to discontinue a credit rating, the information disclosed shall include full reasons for the decision.

The first subparagraph shall also apply to credit ratings that are distributed by subscription.

2. Credit rating agencies shall ensure that credit ratings and rating outlooks are presented and processed in accordance with the requirements set out in Section D of Annex I. ';

- (13) Article 11(2) is replaced by the following:

'2. Any registered and any certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data including the ratings transition frequency and information about credit ratings issued in the past and on their changes. A credit rating agency shall provide information to that repository on a standard form as provided for by ESMA. ESMA shall make that information accessible to the public and shall publish summary information on the main developments observed on an annual basis.';

- (14) the following Article 11a is inserted:

'Article 11a

European Rating Index

1. Any registered and any certified credit rating agency shall, when issuing a credit rating or a rating outlook, submit to ESMA rating information, including the rating and outlook of the rated instrument, information on the type of rating, the type of rating action, and date and hour of publication. The rating submitted shall be based upon the harmonised rating scale referred to in point (a) of Article 21(4a).

2. ESMA shall establish a European Rating Index which will include all credit ratings submitted to ESMA pursuant to paragraph 1 and an aggregated rating index for any rated debt instrument. The index and individual credit ratings shall be published on ESMA's website.';

- (15) in paragraph 1 of Article 14, "Community" is replaced by "Union";

- (16) Article 18(2) is replaced by the following:

"2. ESMA shall communicate to the Commission, to EBA, to EIOPA, the competent authorities and the sectoral competent authorities, any decision under Articles 16, 17 or 20."

- (17) Article 19(1) is replaced by the following:

'1. ESMA shall charge fees to the credit rating agencies in accordance with this Regulation and the regulation on fees referred to in paragraph 2. Those fees shall fully cover ESMA's necessary expenditure relating to the registration, certification and supervision of credit rating agencies and the reimbursement of any costs that the competent authorities may incur carrying out work pursuant to this Regulation, in particular as a result of any delegation of tasks in accordance with Article 30';

- (18) Article 21 is amended as follows:

(a) paragraph 4 is amended as follows:

(i) the introductory sentence is replaced by the following:

'ESMA shall develop draft regulatory technical standards to specify:'

(ii) point (e) is replaced by the following:

'(e) the content and format of ratings data periodic reporting to be requested from registered and certified credit rating agencies for the purpose of ongoing supervision by ESMA.'

(iii) the following subparagraphs are added after point (e):

'ESMA shall submit those draft regulatory technical standards to the Commission by 1 January 2012.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1095/2010.'

(b) the following paragraph 4a is inserted:

'4a. ESMA shall develop draft regulatory technical standards to specify:

- (a) a harmonised standard rating scale to be used, in accordance with Article 11a, by registered and certified credit rating agencies, which will be based upon the metric to measure credit risk and the number of rating categories and cut off values for each rating category;
- (b) the content and the presentation of the information, including structure, format, method and timing of reporting that credit rating agencies shall disclose to ESMA in accordance with Article 11a (1); and
- (c) the content and format of periodic reporting on fees charged by credit rating agencies to be requested from the credit rating agencies for the purpose of ongoing supervision by ESMA.

ESMA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1095/2010.';

(c) a new subparagraph is added to paragraph 5:

'That report shall also assess the market concentration levels, the risks arising from high concentration, and the impact on the overall stability of the financial sector.';

(19) Article 22a is amended as follows:

(a) the title of the Article is replaced by the following:

'Examination of rating methodologies';

(b) the following paragraph 3 is added:

'3. ESMA shall also verify that any intended changes to rating methodologies notified by a credit rating agency in accordance with Article 8(5a) comply with the criteria laid down in Article 8(3) as specified in the regulatory technical standard referred to in point (d) of Article 21(4). The credit rating agency may only apply the new rating methodology after ESMA has confirmed the methodology's compliance with Article 8(3).

[ESMA shall be able to exercise the powers referred to in the first subparagraph from the date of entry into force of the regulatory technical standard referred to in point (d) of Article 21(4) of Regulation 1060/2009.]

Where the regulatory technical standard referred to in point (d) of Article 21(4) is not in force, ESMA shall not be able to exercise the power referred to in the first subparagraph.'

(20) The following Title IIIa is inserted after Article 35:

'TITLE IIIa

CIVIL LIABILITY OF CREDIT RATING AGENCIES

Article 35a

Civil liability

1. Where a credit rating agency has committed intentionally or with gross negligence any of the infringements listed in Annex III having an impact on a credit rating on which an investor has relied when purchasing a rated instrument, such an investor may bring an action against that credit rating agency for any damage caused to that investor.

2. An infringement shall be considered to have an impact on a credit rating if the credit rating that has been issued by the credit rating agency is different from the rating that would have been issued had the credit rating agency not committed that infringement.

3. A credit rating agency acts with gross negligence if it seriously neglects duties imposed upon it by this Regulation.

4. Where an investor establishes facts from which it may be inferred that a credit rating agency has committed any of the infringements listed in Annex III, it will be for the credit rating agency to prove that it has not committed that infringement or that that infringement did not have an impact on the issued credit rating.

5. The civil liability referred to in paragraph 1 shall not be excluded or limited in advance by agreement. Any clause in such agreements excluding or limiting the civil liability in advance shall be deemed null and void.'

(21) Article 36a is amended as follows:

(a) in paragraph 2, points (a) to (e) are replaced by the following:

- '(a) for infringements referred to in points 1 to 5, 11 to 15, 19, 20, 23, 26a to 26d, 28, 30, 32, 33, 35, 41, 43, 50 and 51 of Section I of Annex III, the fines shall amount to at least EUR 500 000 and shall not exceed EUR 750 000;
- (b) for the infringements referred to in points 6 to 8, 16 to 18, 21, 22, 24, 25, 27, 29, 31, 34, 37 to 40, 42, 45 to 49a, 52 and 54 of Section I of Annex III, the fines shall amount to at least EUR 300 000 and shall not exceed EUR 450 000;
- (c) for the infringements referred to in points 9, 10, 26, 26e, 36, 44 and 53 of Section I of Annex III, the fines shall amount to at least EUR 100 000 and shall not exceed EUR 200 000;
- (d) for the infringements referred to in points 1, 6, 7 and 8 and 9 of Section II of Annex III, the fines shall amount to at least EUR 50 000 and shall not exceed EUR 150 000;
- (e) for the infringements referred to in points 2, 3a, 3b, 4, 4a and 5 of Section II of Annex III, the fines shall amount to at least EUR 25 000 and shall not exceed EUR 75 000;';

(b) in paragraph 2, points (g) and (h) are replaced by the following:

- '(g) for the infringements referred to in points 1 to 3a and 11 of Section III of Annex III, the fines shall amount to at least EUR 150 000 and shall not exceed EUR 300 000;
- (h) for the infringements referred to in points 4, 4a, 4b, 4c, 6, 8 and 10 of Section III of Annex III, the fines shall amount to at least EUR 90 000 and shall not exceed EUR 200 000;';

(22) in Article 38a, paragraph 1 is replaced by the following:

'1. The power to adopt delegated acts referred to in the third subparagraph of Article 5(6), Article 19(2), Article 23e(7) and Article 37 shall be conferred on the Commission for a period of four years from 1 June 2011. The Commission shall draw up a report in respect of the delegated power at the latest six months before the end of the four-year period. The delegation of power shall be automatically extended for periods of an identical duration, unless the European Parliament or the Council revokes it in accordance with Article 38b.';

(23) in Article 38b, paragraph 1 is replaced by the following:

'1. the delegation of power referred to in the third subparagraph of Article 5(6), Article 19(2), Article 23e(7) and Article 37 may be revoked at any time by the European Parliament or by the Council.';

(24) Article 39 is amended as follows:

- (a) paragraph 1 is replaced by the following:

'By 7 December 2012, the Commission shall make an assessment of the application of this Regulation, including an assessment of the reliance on credit ratings in the Union, the impact on the level of concentration in the credit rating market, the cost and benefits of impacts of the Regulation and of the appropriateness of the remuneration of the credit rating agency by the rated entity (issuer-pays model), and submit a report thereon to the European Parliament and the Council';

- (b) the following paragraph 4 is added:

'4. By 1 July 2015, the Commission shall assess the situation in the credit rating market, in particular the availability of sufficient choice in order to comply with the requirements set out in Articles 6b and 8b. The review shall also assess the need to extend the scope of the obligations in Article 8a to include other financial products, including covered bonds';

- (25) Annex I is amended in accordance with Annex I to this Regulation;
- (26) Annex II is amended in accordance with Annex II to this Regulation;
- (27) Annex III is amended in accordance with Annex III to this Regulation.

Article 2

Entry into force

This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.

However, points (7), (9), (10), (12), (13) and (25) of Article 1 of this Regulation shall apply from 1 June 2014 for the purposes of the assessment referred to in Article 4(3)(b) and in point (b) of the second subparagraph of Article 5(6) of Regulation (EC) No 1060/2009 as to whether third country requirements are at least as stringent as the requirements set out in Articles 6 to 12 of that Regulation.

Point (8) of Article 1 of this Regulation in relation to Article 6a(1)(a) of Regulation (EC) No 1060/2009 shall apply from [1 year after the entry into force of this Regulation] as regards any shareholder or member of a credit rating agency which on 15 November 2011 held 5% or more of the capital of more than one credit rating agency.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the European Parliament
The President

For the Council
The President

ANNEX I

Annex I to Regulation (EC) 1060/2009 is amended as follows:

(1) Section B is amended as follows:

(a) point 1 is replaced by the following:

'1. A credit rating agency shall identify, eliminate or manage and disclose, clearly and prominently, any actual or potential conflicts of interest that may influence the analyses and judgments of its rating analysts, employees, or any other natural person whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in credit rating activities and persons approving credit ratings and rating outlooks.';

(b) point 3 is amended as follows:

(i) the introductory sentence of the first subparagraph is replaced by the following:

'3. A credit rating agency shall not issue a credit rating or a rating outlook in any of the following circumstances, or shall, in the case of an existing credit rating or rating outlook, immediately disclose where the credit rating or rating outlook is potentially affected by the following:'

(ii) the following point (aa) is inserted after point (a):

'(aa) a shareholder or member of a credit rating agency holding, directly or indirectly, 10% or more of either the capital or the voting rights of that credit rating agency or being otherwise in a position to exercise significant influence on the business activities of the credit rating agency, directly or indirectly owns financial instruments of the rated entity or a related third party or has any other direct or indirect ownership interest in that entity or party, other than holdings in diversified collective investment schemes, including managed funds such as pension funds or life insurance, which do not put him in a position to exercise significant influence on the business activities of the scheme;';

(iii) the following point (ba) is inserted after point (b):

'(ba) the credit rating is issued with respect to a rated entity or a related third party which directly or indirectly holds 10% or more of either the capital or the voting rights of that credit rating agency;';

(iv) the following point (ca) is inserted after point (c):

'(ca) a shareholder or member of a credit rating agency holding, directly or indirectly, 10% or more of either the capital or the voting rights of that credit rating agency or being otherwise in a position to exercise significant influence on the business activities of the credit rating agency, is a member of the administrative or supervisory board of the rated entity or a related third party;';

(v) the second subparagraph is replaced by the following:

'A credit rating agency shall also immediately assess whether there are grounds for re-rating or withdrawing the existing credit rating or credit outlook.';

- (c) the following point 3a is inserted:

'3a. A credit rating agency shall ensure that fees charged to its clients for the provision of rating and ancillary services are not discriminatory and are based on actual costs. Fees charged for rating services shall not depend on the level of the credit rating issued by the credit rating agency or on any other result or outcome of the work performed.';

- (d) in point 4, the first subparagraph is replaced by the following:

'4. Neither a credit rating agency nor any person holding, directly or indirectly, at least 5% of the capital or voting rights of the credit rating agency or otherwise in a position to significantly influence the business activities of the credit rating agency shall provide consultancy or advisory services to the rated entity or a related third party regarding the corporate or legal structure, assets, liabilities or activities of that rated entity or related third party.';

- (e) point 7 is amended as follows:

- (i) point (a) is replaced by the following:

'(a) for each credit rating and rating outlook decision, the identity of the rating analysts participating in the determination of the credit rating or rating outlook, the identity of the persons who have approved the credit rating or rating outlook, information as to whether the credit rating was solicited or unsolicited, and the date on which the credit rating action was taken;';

- (ii) point (d) is replaced by the following:

'(d) the records documenting the established procedures and methodologies used by the credit rating agency to determine credit ratings and rating outlooks;';

- (iii) point (e) is replaced by the following:

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

- (2) Section C is amended as follows:

- (a) in point 2, the introductory sentence is replaced by the following:

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

- (b) in point 3, point (b) is replaced by the following:

- '(b) do not disclose any information about credit ratings, possible future credit ratings or rating outlooks of the credit rating agency, except to the rated entity or its related third party;';
- (c) point 7 is replaced by the following:
 - '7. A person referred to in point 1 shall not take up a key management position with the rated entity or its related third party within six months of the credit rating or rating outlook.'
- (d) point 8 is replaced by the following:
 - '8. For the purposes of Article 7(4):
 - (a) credit rating agencies shall ensure that the lead rating analysts shall not be involved in credit rating activities related to the same rated entity or its related third parties for a period exceeding four years;
 - (b) credit rating agencies others than those mandated by an issuer or its related third party and all credit rating agencies issuing sovereign ratings shall ensure that:
 - (i) the rating analysts shall not be involved in credit rating activities related to the same rated entity or its related third parties for a period exceeding five years;
 - (ii) the persons approving credit ratings shall not be involved in credit rating activities related to the same rated entity or its related third parties for a period exceeding seven years.

The persons referred to points (a) and (b) of the first subparagraph shall not be involved in credit rating activities related to the rated entity or related third parties referred to in those points within two years of end of the periods set out in those points.;

- (3) the title of Section D is replaced by the following:
 - 'Rules on the presentation of credit ratings and rating outlooks';
- (4) Part I of Section D is amended as follows:
 - (a) point 1 is replaced by the following:
 - '1. A credit rating agency shall ensure that any credit rating and rating outlook states clearly and prominently the name and job title of the lead rating analyst in a given credit rating activity and the name and position of the person primarily responsible for approving the credit rating or rating outlook.';
 - (b) point 2 is amended as follows:
 - (i) point (a) is replaced by the following:
 - '(a) all substantially material sources, including the rated entity or, where appropriate, a related third party, which were used to prepare the credit

rating or rating outlook are indicated together with an indication as to whether the credit rating or rating outlook has been disclosed to that rated entity or its related third party and amended following that disclosure before being issued;';

(ii) points (d) and (e) are replaced by the following:

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

(e) information is given as to whether the credit rating concerns a newly issued financial instrument and whether the credit rating agency is rating the financial instrument for the first time; and';

(iii) the following point (f) is added:

'(f) in case of a rating outlook, the time horizon is provided during which a change of the credit rating is expected.';

(c) the following point 2a is inserted:

'2a. A credit rating agency shall accompany the disclosure of methodologies, models and key rating assumptions with guidance which explains assumptions, parameters, limits and uncertainties surrounding the models and rating methodologies used in credit ratings, including simulations of stress scenarios undertaken by the agency when establishing the ratings, credit rating information on cash-flow analysis it has performed or is relying upon and, where applicable, an indication of any expected change in the credit rating. Such guidance shall be clear and easily comprehensible.';

(d) point 3 is replaced by the following:

'3. The credit rating agency shall inform the rated entity during working hours of the rated entity and at least a full working day before publication of the credit rating or the rating outlook. This information shall include the principal grounds on which the rating or outlook is based in order to give the entity an opportunity to draw attention of the credit rating agency to any factual errors.';

(e) the first subparagraph of point 4 is replaced by the following:

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

(f) the first subparagraph of point 5 is replaced by the following:

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

(g) the following point 6 is added:

'6. A credit rating agency shall disclose on its website, on an ongoing basis, information about all entities or debt instruments submitted to it for their initial review or for preliminary rating. Such disclosure shall be made whether or not issuers contract with the credit rating agency for a final rating.';

(5) points 3 and 4 of Part II of Section D are deleted;

(6) in Section D, the following Part III is added:

'III. Additional obligations in relation to sovereign ratings

1. Where a credit rating agency issues a sovereign rating or a related rating outlook, it shall accompany the rating or rating outlook with a detailed research report explaining all the assumptions, parameters, limits and uncertainties and any other element taken into account in determining that rating or outlook. That report shall be clear and easily comprehensible.

2. A research report accompanying a change compared to the previous sovereign rating or related rating outlook shall include the following elements:

- (a) A detailed evaluation of the changes of the quantitative assumption justifying the reasons for the rating change and their relative weight. The detailed evaluation should include a description of the following elements: per capita income, GDP Growth, inflation, fiscal balance, external balance, external debt, an indicator for economic development, an indicator for default and any other relevant factor taken into account. This should be complemented with the relative weight of each factor;
- (b) A detailed evaluation of the changes of the qualitative assumption justifying the reasons for the rating change and their relative weight;
- (c) A detailed description of the risks, limits and uncertainties related to the rating change; and
- (d) A summary of meeting minutes of the rating committee that decided of the rating change.

3. Where a credit rating agency issues sovereign ratings or related rating outlooks, it shall publish these ratings or outlooks only after the close of business of trading venues established in the Union and at least one hour before their opening. Point 3 of Section D.I. remains unaffected.';

(7) Part I of Section E is amended as follows:

(a) point 3 is replaced by the following:

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

(b) point 6 is replaced by the following:

- '6. any material modification to its systems, resources or procedures;
- (8) the first subparagraph of point 2 of Part II of Section E is amended as follows:
- (a) point (a) is replaced by the following:
- '(a) list of fees charged to each client for individual rating and any ancillary services;'
- (b) the following point (aa) is inserted:
- '(aa) its pricing policy, including the fees structure and pricing criteria in relation to ratings for different asset classes;';
- (9) Part III of Section E is amended as follows:
- (a) point 3 is replaced by the following:
- '3. statistics on the allocation of its staff to new credit ratings, credit rating reviews, methodology or model appraisal and senior management, and on the allocation of staff to rating activities with regard to the different asset classes (corporate - structured finance - sovereign);';
- (b) point 7 is replaced by the following:
- '7. financial information on the revenue of the credit rating agency, including total turnover, divided into fees from credit rating and ancillary services with a comprehensive description of each, including the revenues generated from ancillary services provided to clients of rating services and the allocation of fees to ratings of different asset classes. Information on total turnover shall also include a geographical allocation of that turnover to revenues generated in the Union and revenues worldwide;'. '

ANNEX II

In point 1 of Annex II to Regulation (EC) 1060/2009, "Community" is replaced by "Union".

ANNEX III

Annex III to Regulation (EC) 1060/2009 is amended as follows:

(1) Part I is amended as follows:

(a) points 19, 20 and 21 are replaced by the following:

'19. The credit rating agency infringes Article 6(2), in conjunction with point 1 of Section B of Annex I, by not identifying, eliminating or managing and disclosing, clearly or prominently, any actual or potential conflicts of interest that may influence the analyses or judgments of its rating analysts, employees, or any other natural person whose services are placed at the disposal or under the control of the credit rating agency and who are directly involved in the issuing of a credit rating or persons approving credit ratings and rating outlooks.

20. The credit rating agency infringes Article 6(2), in conjunction with the first paragraph of point 3 of Section B of Annex I, by issuing a credit rating or rating outlook in any of the circumstances set out in the first paragraph of that point or, in the case of an existing credit rating, by not disclosing immediately that the credit rating or rating outlook is potentially affected by those circumstances.

21. The credit rating agency infringes Article 6(2), in conjunction with the second paragraph of point 3 of Section B of Annex I, by not immediately assessing whether there are grounds for re-rating or withdrawing an existing credit rating or rating outlook.';

(b) the following new points 26a to 26f are inserted:

'26a. The credit rating agency which entered into a contract with an issuer or its related third party for the issuing of credit ratings on the issuer infringes Article 6b(1) by issuing credit ratings on this issuer for a period exceeding three years.

26b. The credit rating agency which entered into a contract with an issuer or its related third party for the issuing of credit ratings on the debt instruments of the issuer infringes Article 6b(2) by issuing credit ratings on at least ten debt instruments of the same issuer during a period exceeding 12 months or by issuing credit ratings on the debt instruments of the issuer for a period exceeding 3 years.

26c. The credit rating agency which entered into a contract with an issuer alongside at least one more credit rating agency infringes Article 6b(3) by having a contractual relationship with the issuer for a period exceeding six years.

26d. The credit rating agency which entered into a contract with an issuer or its related third party for the issuing of credit ratings on the issuer or its debt instruments of the issuer infringes Article 6b(4) by not respecting the prohibition to issue credit ratings on the issuer or its debt instruments for a period of four years from the end of the maximum duration period of the contractual relationship referred to in paragraphs 1 to 3 of Article 6b.

26e. The credit rating agency which entered into a contract with an issuer or its related third party for the issuing of credit ratings on the issuer or its debt instruments of the issuer infringes Article 6b(6) by not making available at the end of the

maximum duration period of the contractual relationship with the issuer or its related third party a handover file with the required information to an incoming credit rating agency contracted by the issuer or its related third party to issue credit ratings on this issuer or its debt instruments.';

- (c) point 33 is replaced by the following:

'The credit rating agency infringes Article 7(3), in conjunction with point 2 of Section C of Annex I, by not ensuring that a person referred to in point 1 of that Section does not participate in or otherwise influence the determination of a credit rating or rating outlook as set out in point 2 of that Section.';

- (d) point 36 is replaced by the following:

'36. The credit rating agency infringes Article 7(3), in conjunction with point 7 of Section C of Annex I, by not ensuring that a person referred to in point 1 of that Section does not take up a key management position with the rated entity or its related third party within six months of the credit rating or rating outlook.';

- (e) points 38, 39 and 40 are replaced by the following:

'38. The credit rating agency infringes Article 7(4), in conjunction with point (i) of point (b) of the first paragraph of point 8 Section C of Annex I, by not ensuring that, where it provides unsolicited credit ratings, a rating analyst is not involved in credit rating activities related to the same rated entity or its related third parties for a period exceeding five years.

39. The credit rating agency infringes Article 7(4), in conjunction with point (ii) of point (b) of the first paragraph of point 8 of Section C of Annex I, by not ensuring that, where it provides unsolicited credit ratings, a person approving credit ratings is not involved in credit rating activities related to the same rated entity or its related third parties for a period exceeding seven years.

40. The credit rating agency infringes Article 7(4), in conjunction with the second paragraph of point 8 of Section C of Annex I, by not ensuring that a person referred to in points (a) and (b) of the first paragraph of that point is not involved in credit rating activities related to the rated entity or related third parties referred to in those points within two years of the end of the periods set out in those points.';

- (f) point 42 is replaced by the following:

'The credit rating agency infringes Article 8(2) by not adopting, implementing or enforcing adequate measures to ensure that the credit ratings and rating outlooks it issues are based on a thorough analysis of all the information that is available to it and that is relevant to its analysis according to its rating methodologies.';

- (g) point 46 is replaced by the following:

'The credit rating agency infringes the first sentence of the first subparagraph of Article 8(5) by not monitoring its credit ratings other than sovereign ratings or by not reviewing its credit ratings other than sovereign ratings or methodologies on an ongoing basis and at least annually.'

- (h) the following point 46a is inserted:

'46a. The credit rating agency infringes the second subparagraph of Article 8(5) in conjunction with the first sentence of the first subparagraph of Article 8(5) by not monitoring its sovereign ratings or by not reviewing its sovereign ratings on an ongoing basis and at least every 6 months.';

- (i) the following point 49a is inserted:

'49a. The credit rating agency infringes point (c) of Article 8(7) in conjunction with point (c) of Article 8(6) by not re-rating a credit rating where errors on the methodologies or in their application affected the issuance of that credit rating.';

- (2) Part II is amended as follows:

- (a) the following points 3a and 3b are inserted:

'3a. The credit rating agency infringes the second subparagraph of Article 8(5a) by not notifying ESMA of the intended changes to the rating methodologies, models or key assumptions or of the proposed new methodologies, models or key assumptions.

3b. The credit rating agency infringes point (a) of Article 8(7) by not notifying ESMA of discovered errors in its methodologies or in their application.';

- (b) the following point 4a is inserted:

'4a. The credit rating agency infringes Article 11a(1) by not making available the required information or by not providing that information in the required format as referred to in that paragraph.';

- (3) Part III, is amended as follows:

- (a) the following point 3a is inserted:

'3a. The credit rating agency infringes the first subparagraph of Article 8(5a) by not publishing on its website the proposed changes to the methodologies, models or key rating assumptions or the proposed new methodologies, models or key rating assumptions together with a detailed explanation of the reasons for and the implications of the proposed changes.';

- (b) the following points 4a, 4b and 4c are inserted:

'4a. The credit rating agency infringes point (aa) of Article 8(6), where it intends to use new methodologies, by not publishing immediately on its website the new methodologies together with a detailed explanation thereof.

4b. The credit rating agency infringes point (a) of Article 8(7) by not notifying affected rated entities of discovered errors in its methodologies or in their application.

4c. The credit rating agency infringes point (b) of Article 8(7) by not publishing on its website discovered errors in its methodologies or in their application.';

- (c) points 6 and 7 are replaced by the following:

'6. The credit rating agency infringes Article 10(2), in conjunction with point 1 or 2, 2a, the first paragraph of point 4 or points 5 or 6, of Part I of Section D of Annex I, or Parts II or III of Section D of Annex I, by not providing the information as required by those provisions when presenting a credit rating or a credit outlook.

7. The credit rating agency infringes Article 10(2), in conjunction with point 3 of Part I of Section D of Annex I, by not informing the rated entity during working hours of the rated entity and at least a full working day before publication of the credit rating or the rating outlook.