



European Securities and
Markets Authority

Final Report

Guidelines and Recommendations on the Scope of the CRA Regulation



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Acronyms used

CRAs Credit Rating Agencies

EBA European Banking Authority

NCA_s National Competent Authorities as defined in the CRA Regulation, Art. 3(1)(p)

SCA Sectoral Competent Authorities as defined in the CRA Regulation, Art. 3(1)(r)

I. Executive Summary

Reasons for publication

The European Securities and Markets Authority (ESMA) on the basis of the experience acquired so far through the registration process and the supervision of the perimeter of the CRA Regulation¹, sees merit in clarifying the interpretation of the scope of the Regulation with respect to the following items:

- obligation for CRAs to register with ESMA;
- credit rating activities and exemptions from registration;
- establishment of branches outside the Union by registered credit rating agencies;
- specific disclosure recommendations for best practice; and
- enforcement of the scope of the CRA Regulation.

Contents

Section II sets out the feedback statement to the consultation paper (ESMA/2012/841) published by ESMA on 20 December 2012.

Annex I contains the opinion of the Securities and Markets Stakeholder Group.

Annex II contains the full text of the final Guidelines and Recommendations.

Next steps

The Guidelines and Recommendations in Annex II will be translated into all the official languages of the EU and will be published on the ESMA website. The deadline for reporting requirement dates will be two months after the publication of the Guidelines in all the EU official languages.

¹ Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies amended by Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011

II. Feedback Statement

1. ESMA received 17 responses to the consultation paper (CP) on Guidelines and recommendations on the scope of the CRA Regulation (ESMA/2012/841).² Responses were received from credit rating agencies, research and consulting companies, representative associations of credit rating agencies and of institutional investors. The full text of those non-confidential responses received is available on the ESMA website.³
2. Among the answers received, some of them did not specifically respond to the questions posed by the Consultation Paper on the scope of the CRA Regulation. In particular, one respondent suggested that more information is needed in order to allow evaluating the accuracy of credit ratings and facilitating statistical comparison with the accuracy of credit scorings. Another respondent complained in general about the lack of a global regulatory approach to CRAs and its impact to higher regulatory costs for the industry.

ESMA's response: as regards the evaluation of the accuracy of credit ratings, ESMA currently provides free access to its CEREP transparency platform. The CEREP database provides information on credit ratings issued by the CRAs which are either registered or certified in the European Union, and allows investors to assess, on a single platform, the performance and reliability of credit ratings on different types of ratings, asset classes and geographical regions over the time period of choice. The forthcoming CRA³ legislative package will also require ESMA to establish a European Rating Platform which should largely increase public access to credit ratings. As regards the CRA Regulation and third countries' regulatory framework, ESMA is responsible for registration and supervision of CRAs in the European Union and implementing CRA Regulation. Legislative measures are adopted by the European Parliament together with the European Council. ESMA also takes part in the global regulatory dialogue through its participation to the IOSCO SC6 Committee

Obligation to register

Q1. Do you agree with the approach set out above on the obligation to register?

3. A large majority of respondents agreed with the position illustrated by ESMA. Two respondents complained that the obligation for registration introduced by the CRA Regulation for all the CRAs established in the EU represents an unnecessary burden in terms of cost of compliance. Two respondents stated that it should be clarified that credit ratings issued in third countries which are not used in the EU for regulatory purposes do not fall within the reach of the CRA Regulation. Two respondents expressed opposite views as to whether the use of the term "rating" should be limited to registered or certified CRAs, while another respondent stated that on a voluntary basis, the term "rating" should be only used for activities within the scope of the CRA Regulation.

ESMA's response: ESMA is responsible for registering and supervising CRAs in the European Union. As regards ratings issued in third countries which are not used in the EU for regulatory purposes, the Guidelines (Annex II, paragraph 10) specify that the obligation to register with ESMA only applies to legal entities established in the EU. As for the use of the term "rating", the Guidelines (Annex II, paragraph 21) recommend as a best practice that credit scoring firms and CRAs that distribute credit

² <http://www.esma.europa.eu/system/files/2012-841.pdf>

³ <http://www.esma.europa.eu/consultation/Consultation-Guidelines-and-recommendations-scope-CRA-Regulation#responses>

scores should disclose that those scores are not credit ratings issued in accordance with the CRA Regulation.

Q2. What may be alternative/additional criteria to require registration and certification?

4. According to one respondent, the Guidelines should specify that CRAs without a physical presence in the EU should not be registered by ESMA. Further conditions for registration should be that: CRAs should establish a review / compliance function and employ qualified personnel for such tasks; legal entities established in the EU for regulatory purposes must only use credit ratings produced by ESMA-registered credit rating agencies; finally, CRAs which are not established in the EU but which provide rating activities to EU clients via the internet should also be required to register with ESMA.

ESMA's response: The Guidelines (Annex II, paragraph 9) clarifies that those CRAs without a physical presence in the EU should apply for certification for their ratings to be used for regulatory purposes in the EU. In all other cases, CRAs without a physical presence in the EU should not need to apply for certification or for registration with ESMA. As regards additional registration requirements for CRAs such as to have a review and compliance function, registration requirements are provided for in the CRA Regulation, Art. 9 and Annex I Section A(9). As clarified in section IV of the Guidelines below, Art. 4 and 5 of the CRA Regulation state that credit ratings may be used for regulatory purposes in the EU only if they are issued by CRAs registered or certified with ESMA. As regards the provision of credit ratings through internet to EU clients, the Guidelines (Annex II, paragraph 9) clarifies that such activity requires certification by ESMA as a prerequisite if those credit ratings are intended to be used in the EU for regulatory purposes. In no case does the CRA Regulation require registration with ESMA of CRAs without a physical presence in the EU.

Credit rating activities and exemptions from registration

Q3. Do you agree with the explanation of credit ratings provided in this document?

5. Two respondents objected to the example N° 2 published in the Consultation Paper because it restricts the possibilities provided in the CRA3 Regulation in terms of rating scales to be used by CRAs or in general, CRAs' methodological discretionality. Two other respondents objected to example N° 3 in the Consultation Paper because besides the analyst's role in building some of the variables considered in the rating model, there should also be a qualitative role for analysts at the moment of the final deliberation on the rating.

ESMA's response: As regards example N° 2 in the consultation paper, its purpose was not to restrict the scope of credit rating activities subject to registration but to provide one concrete example on the requirement whereby credit ratings under the CRA Regulation should include not only quantitative analysis but also sufficient qualitative analysis, as specified in the Guidelines (Annex II, paragraph 13). As regards example N° 3, ESMA agrees that it should be clear that besides contributing to translate qualitative indicators into quantitative ones, the final rating should not only be the mechanic product of an algorithm but also should be complemented by qualitative human analysis.

Q4. Do you believe that the intervention of rating analysts in the assessment of the relevant information is the key element to distinguish credit ratings from credit scorings?

6. The great majority of the respondents agreed with the general principle that the qualitative input of rating analysts is the key element in distinguishing ratings from scorings. However, several respondents stressed that the CRA Regulation does not allow clearly distinguishing between credit ratings and scorings. According to one respondent, the analyst should be able for credit ratings to provide his/her personal contribution in addition to the automatic result provided by scoring mechanisms. Moreover, ESMA should improve transparency in the market by providing more information highlighting the value added provided by analysts in the credit rating process vis-à-vis credit scorings. Other respondents were in favour of introducing more objective criteria in order to better define the boundaries between credit ratings and credit scoring such as the accuracy of the rating proposal submitted by the rating analyst or an indicative threshold concerning the number of ratings examined by a single analyst.

ESMA's response: On the basis of Art. 3 of CRA Regulation, the Guidelines (Annex II, paragraph 15) clarifies that additional substantial qualitative input from a rating analyst is a necessary requirement for credit ratings. As regards increased disclosure by ESMA, this final report aims at providing to the public, among other things, clarification on the definition of credit ratings in contrast to credit scorings. As regards identifying more objective criteria to distinguish credit ratings from scorings, the accuracy of the work undertaken by rating analysts must be reflected in CRAs' internal records, as provided for in Annex I, Section B(7)(e) of the CRA Regulation. As regards establishing indicative quantitative thresholds in terms of number of ratings per analyst, differences in CRAs' methodologies and business models do not allow ESMA to fix a threshold which could be applicable to each and all CRAs. However, in its supervisory activity ESMA already takes into account the proportion of ratings per analyst according to the specificities of each CRA's methodology, as ESMA has to supervise the adequacy of resources employed by CRAs (CRA Regulation, Annex I(A)(8)). On the basis of the definition of credit ratings provided in Art 3(1)(a) of the CRA Regulation, ESMA does not believe it is possible to provide in its guidelines further precisions concerning the definition of credit ratings based on factual elements.

Private ratings

Q5. Do you agree with the explanation of private ratings provided?

7. A large majority of the respondents agreed with the proposed text. However, several respondents provided comments on the difficulty for CRAs to monitor the use of private ratings by their clients beyond the stipulation of confidentiality agreements, and one respondent objected to any such monitoring activity. One respondent suggested circumscribing the issue by specifying that private ratings should be the result of a qualitative assessment made by a rating analyst as it is the case for regulatory ratings, with the only difference that ratings are not public or distributed by subscription. Several respondents suggested providing more detailed clarification that transmission of the rating to a third party by the person that ordered it does not always correspond to public disclosure or distribution by subscription.

ESMA's response: In the Guidelines (Annex II, paragraph 16), ESMA has corrected a mistake which was present in para. 40 of the Consultation Paper in order to clarify that ratings responding to an individual order placed by a person is a private rating falling within – and not without - the definition of Art. 2(2)(a) of the CRA Regulation. As regards the possible difficulties for CRAs to monitor the use of private ratings by

their clients, Art 2(2)(a) of the CRA Regulation explicitly prohibits public disclosure or distribution by subscription. Consequently, providers of private ratings should monitor the appropriate use of their private ratings by the recipients. Nevertheless, it is clear that such monitoring should take place through those modalities available to CRAs. This could be put into practice either *ex-ante* through contractual clauses or *ex-post* through making use of information available to the CRA such as violation of previous confidential agreements. In those cases, CRAs should refrain from providing new private ratings to those clients who have already publicly disclosed private rating issued by the same CRA. ESMA has clarified such concept in the Guidelines (Annex II, paragraph 15). Concerning the scope of private ratings, as specified in the Guidelines (Annex II, paragraph 14), the definition of credit ratings provided by Art 3 (1)(a) of CRA Regulation should be read together with the exemption provided in Art. 2(2)(a) by the same Regulation. ESMA has included in paragraph 14 of the Guidelines (Annex II) precisions concerning the possibility of distributing private ratings to a limited number of third parties under confidentiality conditions.

Establishment of branches outside the Union by registered credit rating agencies

Q6. Do you agree with the approach taken in the text above regarding the establishment of branches of registered credit rating agencies outside the Union?

8. Two respondents stated that ESMA should be mindful of the need to take into account the local regulatory framework of the third country where the branch is located. Four respondents also stated that CRAs should have flexibility to determine the best way to ensure that compliance obligations are fulfilled in their branches.

ESMA's response: Following Art. 14(3) of the CRA Regulation, the Guidelines clarify that the specificities of third countries' regulatory framework should not impair ESMA's ability to perform its supervisory competences. As regards compliance obligations and important operational functions concerning branches, the CRA Regulation provides limits to CRAs' organisational flexibility with the objective of allowing ESMA to conduct its supervisory competences also as regards third-country branches of CRAs established in the EU (see Guidelines, Annex II, paragraph 18).

Q7. Do you agree that credit rating agencies should demonstrate that there is an objective reason to conduct certain credit rating activities in branches established outside the Union?

9. Two respondents stated that the meaning of "objective reason" relating to Art. 14(3) of the CRA Regulation should be clarified. One respondent submitted that the reference to objective reasons should be changed in "reasonable and consistent reason" so as to take into account subjective elements in the decision making process. Another respondent also agreed on a limitation of such requirement.

ESMA's response: In the Guidelines (Annex II, paragraph 18) ESMA clarifies that the objective reason is linked to the need to ensure an adequate presence in the third country where the branch is located.

Q8. Do you agree that ESMA's capacity to deliver effective supervision would be impaired where credit rating agencies conducted entirely or prevalently important operational functions, and in particular credit rating activities, in branches outside the EU?

10. One respondent stated that CRAs should be allowed to conduct the majority of their activity through branches located outside the EU. Several respondents proposed as possible solution that ESMA should conclude MoUs with a larger number of third countries. Another respondent submitted that the CRA Regulation specifically contemplates the practice of CRAs outsourcing important operational functions outside of the CRA. It is therefore unclear why a potentially more stringent test is being applied to performing functions in a branch of an EU-registered CRA when it is the same legal entity. The result will be that important operational functions can be outsourced to subsidiaries and to third-party non-CRAs but the functions cannot be conducted within the CRA, through a branch.

ESMA's response: Art. 21 of the CRA Regulation requires ESMA to supervise CRAs established in the EU even if their primary activity is to issue credit ratings concerning third countries which are not used for regulatory purposes in the EU. In this respect, EU-registered CRAs conducting activities through branches located outside the EU cannot impair ESMA's ability to perform its supervisory activities. As for the conclusion of MoUs with third countries, ESMA has currently concluded all the MoUs allowed by the specificities of the regulatory framework of third-countries according to what is provided by the CRA Regulation. In addition, ESMA is constantly following regulatory developments in other third countries. As regards outsourcing of important operational functions, Art. 9 of the CRA Regulation states that outsourcing should not impair the quality of CRAs' internal controls and compliance.

Specific disclosure recommendations for best practice

Q9. Do you agree with the disclosure recommendations indicated above and with their remit?

11. One respondent suggested specifying that credit scores or ratings are distributed to the public in the EU also when the entity issuing the financial instrument is domiciled in the EU. Another respondent observed that it is unclear what "status" should be afforded to best practices and that it would set a dangerous precedent for ESMA to attempt to prescribe or recommend positive actions by entities not falling under the Regulation.

ESMA's response: Reference to the place of domiciliation of the entity issuing the financial instrument in the EU is not relevant to determine whether a rating is distributed in the EU or not. As for the legal status of best practices, they are to be considered as recommendations under Art. 16 of the ESMA Regulation⁴ which is also the legal basis allowing ESMA to formulate recommendations to financial market participants.

Q10. Do you agree that credit scoring firms and export credit agencies that distribute their products to the public in EU should consider ESMA's suggested disclosures that such scores or ratings are not issued in accordance with the CRA Regulation?

12. According to one respondent, the term "rating" should be only used for activities under the scope of CRA Regulation. Two respondents suggested extending the recommendation to any company providing credit scores, CRAs included.

⁴ Regulation (EU) No 1095 of the European Parliament and of the Council of 24 November 2010.



ESMA's response: As for the use of the term “rating”, the CRA regulation does not limit its legal use to registered CRAs. ESMA agrees with the view that the recommendation should be extended to any company providing credit scoring including CRAs (Guidelines, Annex II, paragraph 21).

Q11. Do you agree with ESMA recommendation that the credit scoring firms and export credit agencies retain full responsibility for the disclosure indicated above when their scores or ratings are distributed to the public in the EU via agreement with third parties?

13. The majority of respondents agreed with ESMA's view on this matter.

Enforcement of the scope of the CRA Regulation

Q12. Do you agree that ESMA should take action to prevent any entity from abusively distributing credit ratings in the EU?

14. Two respondents requested to modify the proposed Guidelines by deleting the provision whereby ESMA shall impose fines and periodic penalty payments with respect to CRAs that create impediments to effective ESMA supervision by carrying out entirely (or prevalently) important operational functions in branches outside the EU. Another respondent requested more flexibility to allow CRAs to carry out services outside the EU. According to another respondent, the fining structure provided in the CRA Regulation could lead to disproportionate impacts on smaller CRAs, so that greater flexibility should be afforded to ESMA in respect of the application of the enforcement regime.

ESMA's response: ESMA decided not to accept the request for amendment on the same basis explained above in its answer to comments on Q6, namely that ESMA's ability to perform its supervisory competences with regards to third-country branches should not be impaired by the local regulatory framework. As regards the observation on the fining structure provided for in the CRA Regulation, ESMA applies the CRA regulation and in particular, Article 36 on fines. Conducting credit rating activities in the EU without being registered with ESMA then constitutes an infringement of the CRA Regulation.

Annex I

ADVICE TO ESMA

ESMA Consultation Paper on the Guidelines and Recommendations on the Scope of the CRA II Regulation (ESMA/2012/841)

1. SMSG welcomes the consultation paper with guidelines and recommendations on the scope of the CRA II Regulation.
2. In particular, SMSG welcomes that the paper tackles some aspects which were already underlined in internal comments of the SMSG. In particular SMSG supports the document effort on the differentiation between credit rating and credit scoring, which are different products with different analytical basis, and the clarification on the definition of private ratings.
3. We will focus our comments on some questions we think are the most relevant: for the full content of the proposals please refer to the [ESMA Consultation document](#).

Obligation to register

Q1. Do you agree with the approach set out above on the obligation to register?

4. Yes. It is important to have an obligatory registration for ESMA to be able to supervise the CRAs, and this obligation is already incorporated in CRA II Regulation.

Credit rating activities and exemptions from registration

5. The example given in 3) of paragraph 34 considers as rating under CRA Regulation the output of automatic models that incorporate qualitative inputs transformed into quantitative inputs suitable to be processed by the algorithms in econometric models.
6. But this process seems to lack the “analysis”, the “evaluation”, the “approval” or the “thorough analysis of all information that is available (...) and that is relevant to the analysis” which is typical of a “regulated” rating. Rather it appears to be a scoring.

Q3. Do you agree with the explanation of credit ratings provided in this document?

and

Q4. Do you believe that the intervention of rating analysts in the assessment of the relevant information is the key element to distinguish credit ratings from credit scorings?

7. The “sufficient qualitative analysis” and “substantial rating-specific analytical input” is not well described in the Proposed Guideline of paragraph 35 of the Consultation Paper.

8. It should be clarified that only if most of the analysis is performed with the intervention of rating analysts and the evaluation and approval is done by a group of persons, the output should be considered a credit rating; otherwise it should be considered a credit scoring.

Private ratings

Q5. Do you agree with the explanation of private ratings provided?

9. Yes, although it is difficult ex ante for a CRA to “reasonably conclude that a private rating is to be disclosed to the public” and so to “refrain from issuing that rating”. It would probably be a better solution to ask CRA’s to try to guarantee this in the contract with the person who placed the order and, if that person does not comply with that clause, abstain in the future to have him as a counterparty in a contract, refraining, then, from issuing that rating.

Establishment of branches outside the EU by registered CRAs

Q6. Do you agree with the approach taken in the text above regarding the establishment of branches of registered credit rating agencies outside the Union?

10. Yes, because the establishment of branches outside the EU may raise concerns for the supervision by ESMA of the activities performed through those branches.

Q7. Do you agree that credit rating agencies should demonstrate that there is an objective reason to conduct certain credit rating activities in branches established outside the Union?

11. Yes. This is essential to avoid having CRAs circumventing the endorsement regime through branches established outside the EU.

Q8. Do you agree that ESMA’s capacity to deliver effective supervision would be impaired where credit rating agencies conducted entirely or prevalently important operational functions, and in particular credit rating activities, in branches outside the EU?

12. The approach set forth by ESMA appears to be too rigid to be proposed in the form of guideline and seems to go over what is in the Regulation.
13. Even if a CRA operates through branches, ESMA would have the ability to exercise an efficient supervision through the headquarters of the CRA in the EU, and possibly with the cooperation of the third country competent authority.
14. If EU CRA internationalize in the future, ESMA should not interfere with the freedom of that expansion, being normal, in such a situation, to have most of the CRA activity outside the EU.



Specific disclosure best practices

Q9. Do you agree with the disclosure best practices indicated above and with their remit?

15. Yes, it is fair to state that credit scores or ratings are considered to be distributed to the public in the EU when they are disclosed to an undetermined or undeterminable generality of individuals domiciled in the EU or through a website registered with a domain corresponding to one of the Member States of the EU.

Q10. Do you agree that credit scoring firms and export credit agencies that distribute their products to the public in EU should consider ESMA's suggested disclosures that such scores or ratings are not issued in accordance with the CRA Regulation?

16. Yes. This is the only way to guarantee that there is no misunderstanding leading to the use of scorings as ratings issued in accordance with the CRA Regulation.

Q11. Do you agree with ESMA recommendations that the credit scoring firms and export credit agencies retain full responsibility for the disclosure indicated above when their scores or ratings are distributed to the public in the EU via agreement with third parties?

17. Yes. This is the simplest and most effective way of doing it to guarantee the disclosure is done.

Enforcement of the scope of the CRA Regulation

Q12. Do you agree that ESMA should take action to prevent any entity from abusively distributing credit ratings in the EU?

18. Yes. This empowerment comes directly from the CRA Regulation.

Annex II: Guidelines and recommendations on the Scope of the CRA Regulation

I. Scope

Who?

1. These Guidelines and recommendations are addressed to:
 - a. credit rating agencies (as defined in the Article 3(1)(a) of the CRA Regulation);
 - b. NCAs and SCAs.

When?

2. These Guidelines and recommendations will be published in all EU official languages.

II. Purpose

3. The purpose of these guidelines and recommendations is to provide a clarification of the scope of the CRA Regulation, in particular of the provisions thereof concerning the following specific matters:
 - a. obligation to register;
 - b. credit rating activities and exemptions from registration;
 - c. private ratings;
 - d. establishment of branches in third countries;
 - e. specific disclosure recommendations for credit scoring firms and CRAs established in third countries;
 - f. enforcement of the scope of the CRA Regulation and Cooperation with National Competent Authorities.

III. Compliance and reporting obligations

Status of the Guidelines and Recommendations

4. This document contains Guidelines and Recommendations issued under Article 16 of the ESMA Regulation. In accordance with Article 16(3) of the ESMA Regulation competent authorities and financial market participants must make every effort to comply with the Guidelines and Recommendations.
5. Competent authorities to whom the Guidelines and Recommendations are addressed should incorporate them into their supervisory practices, including where particular guidelines within the document are directed primarily at financial market participants.

6. As regards all the other chapters of these Guidelines and Recommendations, NCAs and financial market participants are required to comply with the provisions of the CRA Regulation, while ESMA has the duty to ensure the application thereof.
7. The clarifications provided in the present Guidelines are relevant for the application of the provisions of the CRA Regulation.

Reporting requirements under art. 16 of ESMA Regulation

8. Competent authorities to which paragraph 26 of these guidelines is addressed must notify ESMA to info@esma.europa.eu whether they comply or intend to comply with the Guidelines and Recommendations, with reasons for non-compliance, within two months of the date of their publication by ESMA in all the EU official languages. In the absence of a response by this deadline, competent authorities will be considered as non-compliant. A template for notifications is available from the ESMA website.

IV. Obligation to register under Art. 2(1), 3(b), 4, 5, and 14(1) of the CRA Regulation

9. Credit rating agencies without a physical presence in the EU and fulfilling the prerequisites of Article 5 of the CRA Regulation shall obtain certification from ESMA before distributing credit ratings for regulatory purposes in the EU.
10. Credit rating agencies established in the EU that are carrying out credit rating activities in the EU without prior registration are operating in breach of Article 2(1) and 14(1) of the CRA Regulation. Any credit rating agency that intends to carry out credit rating activities shall immediately apply for registration by ESMA. Entities must not issue credit ratings until they are registered as CRAs. Such obligations also apply to legal entities established in the EU which employ rating analysts providing rating services to a third-country entity.
11. Only a legal person can apply for registration. A natural person cannot apply for registration.
12. ESMA shall take a supervisory measure according to Article 24 of the CRA Regulation against credit rating agencies that operate without registration or, where appropriate, certification in the Union and impose a fine pursuant to Article 36a and Annex III.54 of the CRA Regulation.

V. Credit rating activities and exemptions from registration (Art. 2 and 3 of the CRA Regulation)

13. Credit ratings, as defined in Article 3(1)(a) of the CRA Regulation, include quantitative analysis and sufficient qualitative analysis, according to the rating methodology established by the credit rating agency. A measure of creditworthiness derived from summarising and expressing data based only on a

pre-set statistical system or model, without additional substantial qualitative rating-specific analytical input from a rating analyst should not be considered as a credit rating.

14. A rating which is provided to different persons belonging to a list of subscribers does not fall within the definition of “private rating” in Article 2(2)(a) of the CRA Regulation. On the other hand, Article 2(2) of the CRA Regulation does not mean that any transmission of the rating to a third party by the person that ordered it would correspond to public disclosure or distribution by subscription. The recipient of a private rating is allowed to share the rating with a limited number of third parties and on a strictly confidential basis – as long as such disclosure does not correspond to public disclosure or distribution by subscription - to ensure that the private rating is not disclosed further. For instance, when applying for a loan, the recipient of a private rating may share his rating with his bank on a strictly confidential basis, or a bank can circulate a private rating to a restricted number of other banks for the purposes of a business transaction.
15. In accordance with Article 2(2)(a) of the CRA Regulation, credit rating agencies should ensure that the agreements for the issuance of private ratings cover the duty of confidentiality and limitations on the distribution of the ratings. When issuing private ratings, credit rating agencies should assess whether the person who placed the order, as recipient of the private rating, has any intention to use the rating in a way that would bring it into the public domain or to use it for regulatory purposes. Where the credit rating agencies can reasonably conclude that a private rating could be disclosed to the public, for instance taking into account that the same client already breached the duty of confidentiality in the past, ESMA recommends as a best practice that credit rating agencies should put in place the necessary measures to avoid such disclosure or refrain from issuing that rating.

VI. Establishment of branches outside the Union by registered credit rating agencies under art. 14(3) of the CRA Regulation

16. Since branches do not have a separate legal personality from their parent, credit ratings issued in branches established outside the Union are deemed to be issued by their EU parent. Therefore, infringements by the branches of the CRA Regulation are attributable to the parent CRA which shall be the object of ESMA’s supervisory measures, imposition of fines and/or periodic penalty payments.
17. ESMA might be prevented from performing its supervisory tasks if important operational functions of credit rating agencies were based and primarily operated outside the Union. Moreover, CRAs should demonstrate that there is an objective reason for credit ratings to be issued in branches set up outside the Union. For instance, the need to ensure an adequate presence in the third country in question. ESMA would take action according to Article 24, 36a, 36b in case of infringements by CRAs of Annex III part II points 2, 4, 5, 6, 7 and 8 of the CRA Regulation.
18. Important operational functions, as set out in Art. 9 of the CRA Regulation, should not be based or primarily operated in offices established in third-countries with no (or very limited) involvement of

EU-based managers, systems or procedures of the credit rating agency. Important operational functions include units or divisions in charge of elaboration and issuance of credit ratings, credit analysis, rating methodology development and review, compliance, internal quality control, data storage/record keeping and systems maintenance or support. However, the identification of important operational functions may require case-by-case consideration. As regards the compliance function, CRAs should ensure that their internal control system is fully operational also in third-country branches.

19. Credit rating agencies shall not establish branches in third countries to perform activities that are subject to supervision by ESMA if this prevents ESMA from conducting supervisory tasks in relation to such activities of those branches as set out in articles 23b to 23d of the Regulation, including the ability to carry out on-site inspections and investigations. In this respect:
 - a) credit rating agencies should cooperate with ESMA in case of inspections or investigations, including on-site visits, regarding credit ratings or credit rating activities carried out in non-EU branches;
 - b) ESMA will assess the need to enter into cooperation arrangements with the local competent regulators to ensure the adequate supervision of branches located outside the Union;
 - c) prior to establishing branches in third countries, credit rating agencies should ensure that those branches will abide immediately with any request set forth by the officials of ESMA in the exercise of powers pursuant to Articles 23b to 23d of the CRA Regulation, including granting of access to premises, systems and resources in case of on-site inspections and investigations.

VII. Specific disclosure recommendations for best practice relating to Art. 16 (1) of ESMA Regulation

22. ESMA recommends as a best practice that credit scoring firms and CRAs that distribute credit scores to the public in the Union should provide clear and prominent disclosure that those scores are not credit ratings issued in accordance with the CRA Regulation. ESMA recommends that this disclosure should be provided also by export credit agencies that act under Article 2(2)(c) of the Regulation.
23. ESMA recommends as a best practice that where credit scoring firms and export credit agencies decide to publish such information, they should retain full responsibility for the disclosure indicated in the previous paragraphs when their credit scores or ratings are distributed to the public in the territory of the Union via agreement with third parties.
24. Credit scores or ratings are distributed to the public in the EU when they are disclosed to an undetermined or undeterminable generality of individuals domiciled in the EU for instance, through a press release. Credit scores or ratings are also distributed to the public when they are issued through a website registered with a domain corresponding to one of the Member States of the EU.



VIII. Enforcement of the rules concerning the scope of the CRA Regulation

25. ESMA shall impose periodic penalty payments in order to compel the credit rating agency to put an end to the infringement of issuing credit ratings without being registered by ESMA, and impose fines where appropriate, in accordance respectively with Articles 36(b) and 36(a) of the CRA Regulation.
26. Where a NCA or a SCA receives an application, request for information, or any other form of inquiry concerning the CRA Regulation, including on registration or certification, the Authority should immediately notify ESMA and refer the financial market participant that has submitted the request to ESMA as the sole competent supervisory authority in the Union.