



European Securities and  
Markets Authority

# Thematic Report

**On fees charged by Credit Rating Agencies and Trade Repositories**



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## Executive Summary

1. ESMA directly supervises credit rating agencies (CRAs) and trade repositories (TRs) as part of its mission to safeguard financial stability, enhance investor protection and promote stable and orderly financial markets. In particular, the relevant regulations aim to enhance the integrity, transparency, responsibility, good governance and independence of CRAs/TRs and to facilitate competition in the respective industries.
2. ESMA supervision covers all aspects of CRA and TR activities, including the fees that CRAs and TRs charge their clients. The CRA Regulation (CRAR) requires CRAs to ensure that fees for the credit rating and ancillary services are not discriminatory and based on actual costs. The European Markets Infrastructure Regulation (EMIR) requires TRs to provide non-discriminatory access and charge publicly disclosed and cost-related fees<sup>1</sup>.
3. There are several reasons why ESMA has focused on reviewing the current practices for fees charged in the credit rating and trade repository industries and decided to issue a Thematic Report on the topic.
4. First, the fee provisions were introduced in 2013 for CRAs by amendment to the CRAR (CRAR III amendments) and in 2012 for TRs with the adoption of EMIR. However, since the introduction of these provisions, the available information regarding CRAs' general pricing policies, internal controls and the level of transparency and disclosure did not allow to determine whether the regulatory requirements were met. Likewise, in the TR industry, there was not yet sufficient information for ESMA to conclude whether TR clients receive non-discriminatory access, are charged cost-related fees and are able to estimate their full reporting costs to a TR.
5. Second, ESMA received market information from various users of credit rating and trade repository services that raises questions on the application of the non-discrimination and cost-based/cost-related principles, including:
  - Non-transparent price increases in the credit rating industry which do not seem based on costs, but are rather driven by the value of the product/service for the client that might have discriminatory consequences and prevent fair competition.
  - Users of credit ratings produced by some CRAs are limited in the use of publicly available rating information. In order to use those credit ratings in practice, including for regulatory purposes, they are required to enter into licence agreements. These licence agreements are typically made with an entity related to the registered CRA.

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<sup>1</sup> The requirement to CRAs to ensure that fees charged to their clients for the provision of credit rating and ancillary services are not discriminatory and based on actual costs is embedded in Art. 3c, Section B, Annex I of the CRAR; and the requirement to TRs to provide non-discriminatory access and charge publicly disclosed and cost-related fees is embedded in Art. 78 of EMIR. These provisions are also referred as "the fee provisions" or "the fee requirements" in this Report.

Moreover, while the rating content is generated by the registered CRA, it is common practice that some forms of the distribution and commercialisation of such content is carried out by affiliated entities and therefore falling outside the regulatory perimeter.

- TR fee schedules are not easily comparable for users of TR services and do not support potential clients in identifying which TR would best serve their needs.
  - TR fee schedules do not allow potential clients to have an overview of the total costs of reporting to a TR (e.g. due to different system design or connectivity requirements).
6. ESMA believes there is merit to share the outcome of its review through this Report, provide supervised entities, their clients and other market participants with a summary of its observations, clarity on its main supervisory concerns and supervisory focus going forward as well as on areas for improvement in CRAs/TRs practices.
7. The following are ESMA's key areas of concern across the CRA and TR industries with regard to the fee provisions and where improvements are needed in the CRAs/TRs practices:
- Transparency and disclosure: need to ensure sufficiency and clarity of information provided to actual and potential clients as well as to ESMA, aiming at reducing the existing information gap between CRAs/TRs and other stakeholders. For CRAs (where public fee schedules are not mandated by the CRAR), clients should be able to understand the key elements of the fee schedule, the reasons for deviations from it as well as the reasons of price increase/decrease. For TRs (where public fees are mandated by EMIR), more transparency can still be achieved through reducing complexity and increasing comparability of TRs' fee schedules, as well as disclosing sufficient information to enable clients to estimate any additional reporting cost, including establishment of access and connection to a TR. On ESMA's side, more information is needed around CRAs/TRs' costs, price deviations and relevant internal controls established by CRAs and TRs.
  - Fee-setting process, including cost monitoring and related controls: need to ensure that cost is a key pricing factor and sufficient controls are in place in order to demonstrate that the regulatory objectives are met.
  - Interaction with related entities: need to ensure that group support and/or interaction with related entities do not conflict with the non-discrimination and cost-based/cost-related principles, and that ESMA has sufficient information to identify possible risks.
8. Following the publication of the Report, ESMA will continue to engage with both supervised entities and their clients to ensure effective supervision of the fee provisions (e.g. on costs, price deviation, controls in place). ESMA will explore possible options to further enhance the clarity in some areas and concepts (e.g. costs of services; comparability of TRs' fee schedules; group support provided by TRs' affiliates; distribution of rating content performed by CRAs' affiliates; right to use credit rating information

produced by CRAs). ESMA may also decide to provide further supervisory guidance to ensure compliance with relevant requirements.

9. Section 1 introduces the main body of the report and some background information. Section 2 and Section 3 set out ESMA's observations, areas of concern, supervisory approach, and next steps respectively for the CRA and TR industries. The Annexes provide additional legal information (Annex I) and a summarising fact-sheet (Annex II).
10. Any findings or supervisory concerns highlighted in this report are without prejudice to any action ESMA may take in the future on fee supervision.

# 1 Introduction

11. There are two principles that underpin the regulatory provisions on fees charged for credit rating and trade repository services: “non-discriminatory” and “cost-based” / “cost-related”. The present regulations do not develop specific criteria to define what is “non-discriminatory” and “cost-based”. Therefore, these terms should be interpreted in conjunction with other provisions of the CRAR and EMIR, the legislator’s intent, and existing business practices within the industries (see Annex I for further information on the legal framework).

## **What is “non-discriminatory”?**

12. For the purpose of this report, “non-discriminatory” means not charging different prices to different clients for the same products or services when the costs of providing these products or services are similar. Practices where a CRA or a TR bases its fees on the value, perceived or estimated, to their client rather than on the cost of the service/product (i.e. value-based pricing) would be considered a form of price discrimination. At the same time, the non-discriminatory requirement does not prevent CRAs and TRs from offering price deductions, such as discount programmes, rebates, special offers and pricing programmes, if they are offered to all users on the same grounds. To assess whether special offers are harmful to the market it is crucial to consider the market power<sup>2</sup> of the entity using the pricing practices and the effect of the practices.
13. The European Commission’s Impact Assessment accompanying the Proposal for a Regulation amending CRAR (CRAR III)<sup>3</sup> defines “not – discriminatory” practices as fully based on the costs and not based on any form of contingency, thus stressing the link between non-discriminatory and cost-based principles.
14. The CRAR further explains that *“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 clients 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 clients”*<sup>4</sup>.
15. For the EMIR provisions on fees, it should be noted that non-discriminatory access to TRs is a broader requirement that goes beyond pricing practices. The Principles for Financial Market Infrastructures (PFMIs)<sup>5</sup> provides further information on the legislator’s rationale

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<sup>2</sup> See ESMA Technical Advice: Competition, choice and conflicts of interest in the credit rating industry; 30 September 2015 ESMA/2015/1472, published at [https://www.esma.europa.eu/sites/default/files/library/esma-2015-1472\\_technical\\_advice\\_on\\_competition\\_choice\\_and\\_conflicts\\_of\\_int.pdf](https://www.esma.europa.eu/sites/default/files/library/esma-2015-1472_technical_advice_on_competition_choice_and_conflicts_of_int.pdf) for market definition and market power analyses.

<sup>3</sup> EC Staff Working Paper SEC(2011) 1354 Impact Assessment accompanying the document Proposal for a Regulation amending Regulation (EC) No 1060/2009 on credit rating agencies and a Proposal for a Directive amending Directive 2009/65/EC on coordination on laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Fund Managers (COM(2011) 746), {COM(2011) 747},{SEC(2011) 1355}

<sup>4</sup> Recital 38 of Regulation (EU) No 462/2013 of the European Parliament and Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies

<sup>5</sup> Principles for financial market infrastructures published by the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions In April 2012 <http://www.bis.org/cpmi/publ/d101a.pdf>

regarding the coverage of these provisions. Principle 18 prescribes that a Financial Market Infrastructure (FMI) should have “*objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access*”. The PFMI’s explain in particular that the non-discrimination provision aims at i) ensuring fair and open access to TR services to the extent possible and ii) not differentiating between specific types and classes of participants.

16. The PFMI’s develop further the meaning of “*fair and open access to TRs*” and prescribe that “*a TR should provide terms of use that are commercially reasonable and are designed to support interconnectivity with other FMIs and service providers, where requested, so that competition and innovation in post-trade processing are not impaired as a result of centralising recordkeeping activity*”<sup>6</sup>. The Principles further specify that “*a TR should not engage in anti-competitive practices such as product or service tying, setting overly restrictive terms of use, or anti-competitive price discrimination*”<sup>7</sup>.

### **What is “cost-based” / “cost-related”?**

17. The other key concept for the regulation of fees is the “cost-based” (for CRAs) and “cost-related” (for TRs) requirement. Similarly, the regulations do not develop on how this principle should be applied. Therefore, the interpretation should be in line with other provisions of the CRAR and EMIR.
18. From a semantic point of view, “cost-based” appears to be a more stringent notion compared to “cost-related”. However, the focus of both the CRAR and EMIR provisions is that price setting should not be arbitrary and the baseline for price setting should be costs rather than any other possibly discriminatory criteria. The legislator seeks costs to be the underlying factor in pricing policy, while no factual importance seems to be given to the level at which the costs determine the fee. Therefore, considering that the CRAR and EMIR establish concepts which are closely related, ESMA will apply a similar supervisory approach to ensure that costs are a key factor of CRAs and TRs’ pricing.
19. The analysis of existing market practices suggests that companies use different pricing models depending on the nature of their business and needs. Cost-based pricing (or “cost-plus” pricing), value-based pricing and dynamic pricing (or demand pricing) are among prevailing pricing models. Companies with cost-based pricing use the production costs as a basis to set the final price by adding a profit margin. Cost-based pricing is different from value-based pricing in that in value-based pricing the company determines how much money or value its product/service would generate for the client and bases its price on this assessed value. Cost-plus pricing is also different from dynamic pricing (also referred to as demand pricing) in which businesses define and change prices, for instance based on algorithms, that take into account competitor pricing, supply, demand and other external factors. When prescribing that fees should be cost-based/cost-related, the legislator

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<sup>6</sup> See para 3.18.4. page 102 of the PFMI’s

<sup>7</sup> Idem

appears to not allow CRAs and TRs to have other models than cost-based pricing, like value-based and dynamic pricing.

20. The cost-based/cost-related provision implies that CRAs and TRs are required to record and maintain costs of their services/products and be transparent about the underlying costs with their clients. The transparency about costs is particularly important when CRAs or TRs modify their fees so that it is clear to their clients whether the increase/decrease occurred due to an increase/decrease in the underlying costs or due to a decision to raise/decrease the margin.

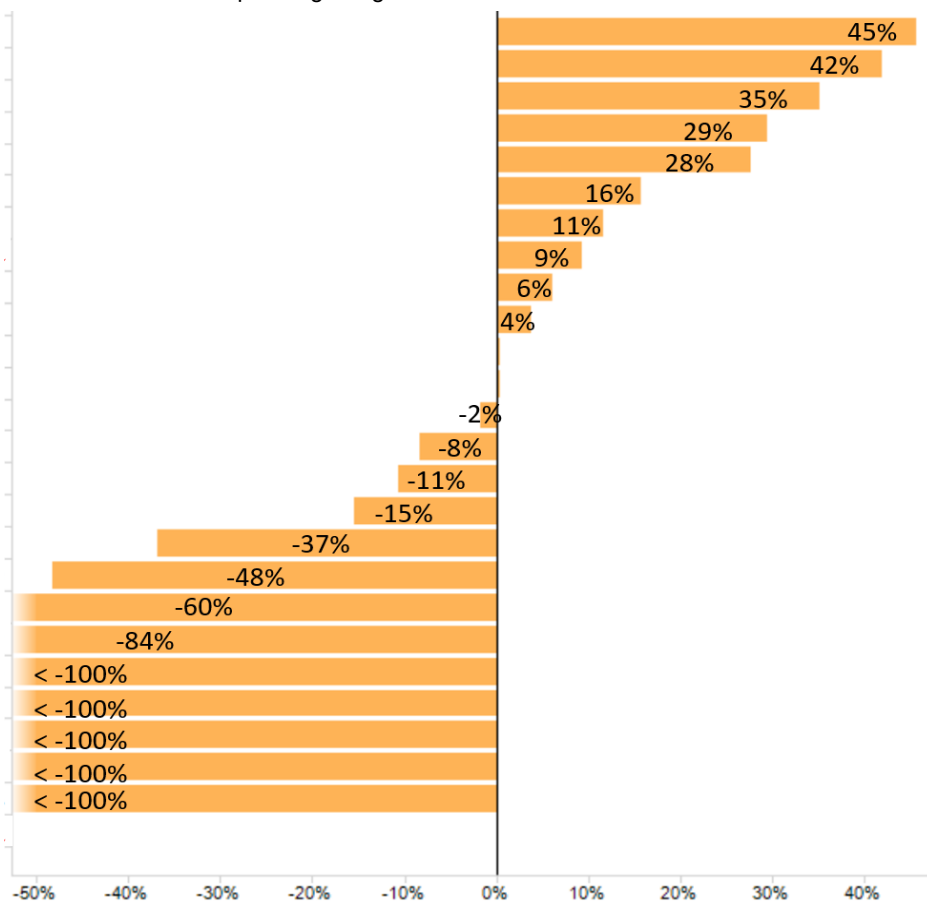


## 2 CRA Industry practices – key findings, concerns and supervisory approach

### *Industry dynamics, competition environment and CRAs' practices*

21. The concentration level in the credit rating industry is high with the three largest CRAs accounting for around 95% of total market revenues. The 2015 ESMA Technical Advice on Competition in the Credit Rating Industry<sup>8</sup> demonstrates that the largest CRAs operating globally exercise market power in different product and geographic markets in the CRA industry. Furthermore, the CRAs profitability is uneven with only a handful of EU CRAs being able to deliver high operating margins, around 30% or more.

**Chart 1: EU CRAs' operating margins for 2016**



Source: 2016 financial statements of CRAs registered in the EU.

22. The analysis of both revenues and margins of registered CRAs operating in the EU allows to rank CRAs in terms of their relative market footprint and profitability. This assists in the identification of those CRAs that are likely to have more market power, which could result in more room for fee flexibility and potentially for arbitrary pricing (e.g. price makers), or

<sup>8</sup> See ESMA Technical Advice: Competition, choice and conflicts of interest in the credit rating industry; 30 September 2015 ESMA/2015/1472, also referred to in footnote 2.

can influence the credit rating market dynamics the most. ESMA's supervisory focus and prioritisation is mindful of such considerations.

23. The legislator recognises the limited degree of competition that historically prevails in the industry and has sought to address this issue with a number of requirements<sup>9</sup> including the fee provisions that are the focus of this Report. Moreover, the key objectives of the CRAR to mitigate possible conflicts of interest and to ensure high quality and sufficient transparency of ratings, not only target financial stability and investor protection, but also promote competition. As ESMA noted in the aforementioned Technical Advice on Competition in the Credit Rating Industry, there are a number of features which have impact on the competitive dynamics of the credit rating industry.

#### *Two-sided market - issuers and investors*

24. In its nature, the credit rating industry is a two-sided market: the value of a CRA to issuers on the supply side is influenced by the number and type of investors that prefer or need to use the credit rating information produced by that CRA. Issuers in this market prefer to use the CRAs that are recognised by the largest number of investors, and investors prefer to use those CRAs who can offer the greatest coverage of the issuers and instruments they want to invest in. Fees charged to different client groups are interrelated and CRAs may charge only one side of the market (i.e. the issuer side or the investor side) or may charge both sides of the market.
25. The two-sided nature of the market defines, among other factors, the competition dynamics of the highly concentrated credit rating industry. Only the largest groups, accounting for around 95% of total revenues, are able to operate as platforms on both sides of the market (for issuers and investors), also because they offer access to a large database of credit ratings and rating information. On the other hand, smaller agencies mostly operate only on one side of the market and often remain loss making. It implies that CRAs with significant market power might have more opportunity to set arbitrary or discriminatory fees, and also that their pricing practices can have a major impact on consumer/investor protection and decision making.
26. The fee provision introduced in the CRAR does not make any distinction across the various business models a CRA can establish, notably the "issuer-pays model" (where a CRA is remunerated by the rated entity or a related third party) as opposed to the "investor-pays model" (where a CRA is remunerated by a third party not related to the rated entity). Therefore, regardless of the business model established by the individual market player, the fees charged for credit rating and/or ancillary services, i.e. the fees associated with credit rating data sales to investors/subscribers and the fees associated with the sale of credit ratings to issuers, must satisfy the cost-based and non-discriminatory principles.

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<sup>9</sup> Such as article 8d of the CRAR (Use of multiple credit rating agencies): "*Where an issuer or a related third party intends to appoint at least two credit rating agencies for the credit rating of the same issuance or entity, **the issuer or a related third party shall consider appointing at least one credit rating agency with no more than 10 % of the total market share...***"; and recital 38 of CRAR III: "*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 clients are not discriminatory*".

### *Ratings of large CRAs are not substitutable services*

27. Another important feature of the credit rating industry is that issuers typically solicit two or more ratings from different CRAs for rating an individual entity or financial instrument. This market practice results in the fact that the three larger CRAs serve nearly the entire market and that ratings from those CRAs cannot be regarded as substitutes for one another from the viewpoint of issuers or investors.
28. Another feature of the credit rating services that makes them difficult to substitute is that reputation is an important driver of demand in the credit rating industry. The decision to use the services of selected CRAs is often guided by the awareness that clients have of CRAs in those markets. Therefore, clients do not perceive the services of smaller CRAs as substitutes for the services of large CRAs. This raises barriers to entrance and expansion for smaller CRAs.
29. The above characteristics of the credit rating industry reinforce the key concerns arising in oligopolistic markets as described in the Technical Advice on Competition in the Credit Rating Industry<sup>10</sup> and may increase the risk for large CRAs to set discriminatory and not cost-based prices.

### *Insufficient evidence of CRAs' implementation of the fee provision*

30. After several years following the introduction of the fee provision, the available information regarding CRAs' general pricing policies, internal controls and the level of transparency and disclosure did not allow to determine whether the regulatory requirements were met.
31. While ESMA has received annual information on fees charged by CRAs for the purpose of its ongoing supervision<sup>11</sup>, ESMA notes limited proactive engagement from CRAs with regard to the development of their fee schedule. There is insufficient information on how CRAs apply the fee schedules, whether and why deviations from the fee schedule occur, how non-discriminatory pricing is preserved in case of deviations, what has been done to contribute to increased transparency, as well as the internal controls put in place to ensure compliance with the fee provisions of the CRAR.
32. This was also one of the key reasons why ESMA launched a thematic review on fees. With this review, ESMA has aimed at developing a comprehensive level of knowledge and understanding of the practices CRAs established around the fees charged to clients.

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<sup>10</sup> See section 3.4. Market definition and Market power of ESMA Technical Advice: Competition, choice and conflicts of interest in the credit rating industry; 30 September 2015 ESMA/2015/1472, also referred in footnote 2.

<sup>11</sup> As established by the Commission Delegated Regulation 2015/1 (the Delegated Regulation on Fee) of 30 September 2014 with regard to regulatory technical standards for the periodic reporting of fees charged by credit rating agencies, OJ L2/1 of 6.1.2015 available at: [http://eur-lex.europa.eu/legalcontent/EN/TXT/?uri=OJ:JOL\\_2015\\_002\\_R\\_0001](http://eur-lex.europa.eu/legalcontent/EN/TXT/?uri=OJ:JOL_2015_002_R_0001).

### *Key findings and ESMA's areas of concerns*

33. As part of its review, ESMA has analysed periodic information<sup>12</sup>, engaged with CRAs (including through a dedicated roundtable organised at ESMA in June 2017), and has reached out to other stakeholders, including issuers, investors and other users of ratings. The involvement of all relevant stakeholders has been essential in developing ESMA's understanding of market practices and key areas of supervisory focus and ESMA will continue to seek feedback going forward.
34. ESMA's assessment identified three key areas of focus representing the three pillars of ESMA's approach to the supervision of fees charged for credit rating and ancillary services.
- a) Transparency and disclosure: based on the assessment of the information stored in ESMA's repositories, together with the information disclosed to the market and clients, there are limitations in the level of transparency by CRAs. In particular, ESMA is concerned about the sufficiency and clarity of information disclosed to both ESMA and the market and aims at enhancing both aspects. Higher transparency and disclosure towards ESMA, for instance around CRAs' costs, price deviation and relevant internal controls established, is needed to ensure ESMA supervision is effective and based on all relevant information. Higher transparency and disclosure towards the market is also needed to empower clients to make more informed decisions based on comparable information. For example, this applies to the key elements of the CRAs' fee schedule, the reasons for deviations as well as the reasons of price increase/decrease. This would create a more level playing field, reducing the information gap between provider and purchaser of credit rating and ancillary services, and ultimately reducing the risk of discriminatory pricing, and possible conflicts of interest.
  - b) Fee setting and cost monitoring: in addition to the current limits on information available, ESMA also identified limitations in CRAs' cost monitoring practices. This curtails the CRAs' ability to ensure that cost information is effectively taken into consideration during the fee setting process and that cost-based and non-discriminatory fees are established. ESMA's supervisory approach aims at enhancing CRAs' cost monitoring and reporting practices.
  - c) Credit rating industry and use of credit ratings: ESMA observes significantly different market power across different CRAs in the credit rating industry. Further, CRAs are typically part of groups that organise their business in different ways. ESMA has identified risks to both users of ratings and the objectives of ESMA (e.g. investor protection) and the CRAR (e.g. fees charged and possible conflicts of interest) from the business model established by the global and more complex groups. In particular, ESMA is concerned about the business practices and relationship between registered CRAs and their affiliated entities, which are used to provide the financial market with

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<sup>12</sup> See Guidelines on Periodic Information to be submitted to ESMA by Credit Rating Agencies; 23 June 2015 ESMA/2015/609, published at <https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-609.pdf>

credit ratings and related information originated from the CRA, including commercialisation and delivery services of credit ratings and rating content, and the licencing services for the use of credit ratings.

### ***Transparency and disclosure towards ESMA***

35. In principle, the actual price paid by the client for a particular rating service should be based on the fee schedule applicable for that service, and should be formalised by means of a fee agreement.
36. As indicated in its Final Report on draft Regulatory Technical Standards required under CRAR III<sup>13</sup>, ESMA will use data reported by CRAs to identify and investigate outliers. RADAR (RATings DAta Reporting tool), the IT system developed by ESMA to support CRA reporting, is used by CRAs to submit to ESMA general pricing practices and the fees received from each of their clients for credit ratings and ancillary services.
37. However, RADAR data does not provide straightforward links between fee schedules and the actual price charged to the client. More precisely, discrepancies have been observed between the actual price paid by the client for a particular product/service and the theoretical price the CRA should have charged if the fee schedule had been applied as set out.
38. Given the limitations of the data currently included in RADAR, ESMA asked CRAs for additional information, including fees and costs information and copies of contractual agreements, relating to the products and services provided by the CRAs' group.
39. However, even with the additional information made available to ESMA, establishing a reliable connection between the price that should be charged according to the fee schedule and the actual price paid by the client is not straightforward. While the availability of this information on a regular basis would allow for a better and systematic identification of those cases where the actual price paid by the client deviates from the theoretical price set by the fee schedule, the reasons behind such deviations cannot be inferred by only analysing the pricing data.
40. The Charts 2, 3 and 4 below are based on the information provided by CRAs and illustrate the discrepancies between the actual price paid by the client and the price that should have been charged if the CRAs had applied the fee schedule as set out.
41. Chart 2 depicts, in absolute terms, the total number of rating services for which the price paid by the client could be matched to a fee agreement and, respectively, to a fee schedule. It can be observed that the number of services for which the prices could be matched is quite low compared to the total number of rating services. The discrepancies

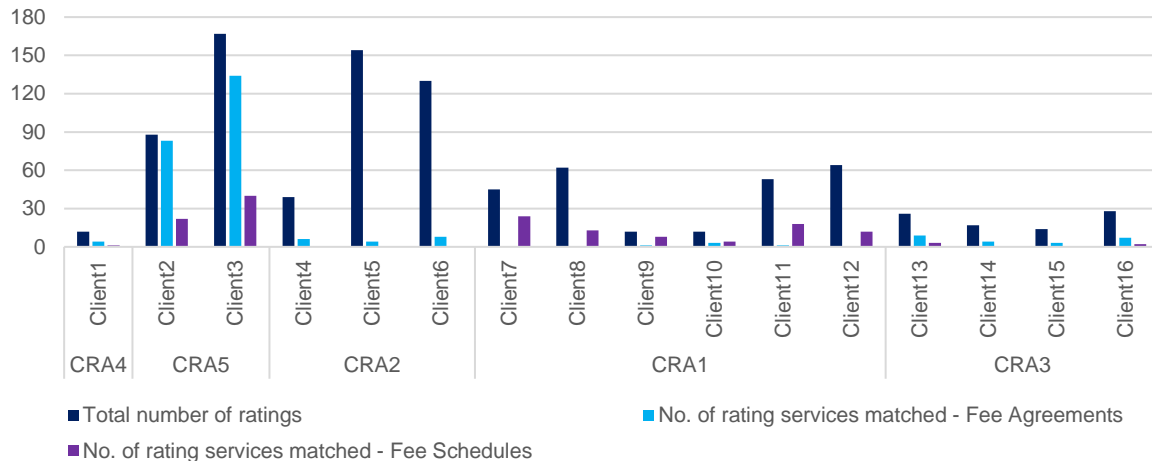
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<sup>13</sup> See ESMA Final Report on draft Regulatory Technical Standards (RTS) required under the Credit Rating Agencies (CRA3) Regulation regarding information on transparency of structured finance instruments, the European Rating Platform and periodic reporting of fees charged by credit rating agencies; 20 June 2014 ESMA/2014/685, published at [https://www.esma.europa.eu/system/files\\_force/library/2015/11/2014-685\\_draft\\_rts\\_under\\_cra3\\_regulation.pdf](https://www.esma.europa.eu/system/files_force/library/2015/11/2014-685_draft_rts_under_cra3_regulation.pdf)

are more or less significant across CRAs, and across different clients of the same CRA.

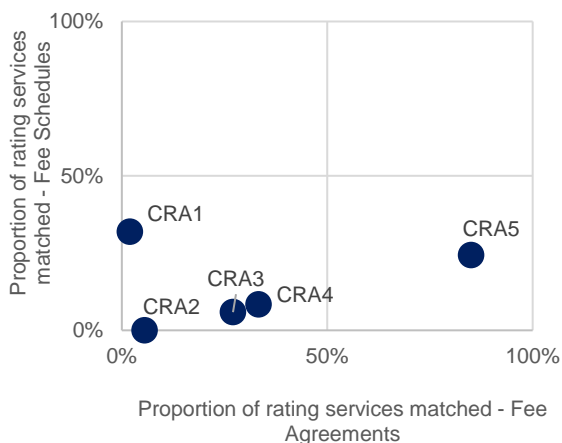
42. Charts 3 and 4 complement Chart 2, and illustrate the proportion and absolute number of services for which the prices charged match the fee agreements and fee schedules, aggregated for the sample of clients covered by ESMA’s request for additional information. These samples consisted of a mix of clients selected on the basis of the fees data reported through RADAR, including clients with high fees, clients with fees but no issued ratings in the calendar year, and clients with no fees reported but with associated ratings. The proportion of rating services for which the actual price paid by the client is in line with the corresponding fee schedule is low for the entire sample of CRAs assessed, and ranges from 0 to 50 per cent (See Chart 3, vertical axis). Similarly, the actual prices paid could not be linked with formal fee agreements for more than half of the sample of ratings assessed, except for one CRA (See Chart 3, horizontal axis).

**Chart 2:** Number of rating services provided vs. number of rating services for which the actual price charged appears in line with the fee schedules and fee agreements, aggregated for the period 2013-2016, for a sample of clients covered by ESMA’s request for additional information



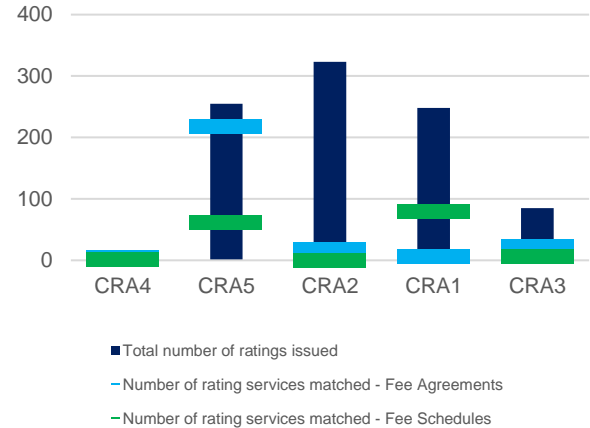
Source: ESMA calculations based on CRAs’ responses to ESMA’s request for additional information.

**Chart 3:** Proportion of rating services for which the actual price charged appears in line with the fee schedules and, respectively, the fee agreements (aggregated figures for the 2013-2016 period, for the sample of clients covered by ESMA’s request for additional information)



Source: ESMA calculations based on CRAs’ responses to ESMA’s request for additional information.

**Chart 4:** Total number of ratings issued vs. number of ratings for which the actual price charged appears in line with the fee schedules (green bar) and fee agreements (blue bar) (aggregated figures for the 2013-2016 period, for the sample of clients covered by ESMA’s request for additional information)



Source: ESMA calculations based on CRAs’ response to ESMA’s request for additional information.

43. According to the analysis summarised above it appears that, based on the information available to ESMA, the actual prices CRAs charge to their clients often differ from the theoretical price set by the fee schedule and the price declared in the fee agreement in force. While such analysis cannot conclusively determine that CRAs deviate from their fee schedule or fee agreements on a regular basis, ESMA notes that continuous deviations can be considered an issue, which deserves supervisory attention. For instance, it could be an indicator of excessive fee flexibility, potentially resulting in arbitrary pricing, or that the fee schedules are disregarded in practice hence failing the purpose for which they were established (i.e. ensuring cost-based and non-discriminatory pricing).
44. Furthermore, the analyses of the data available to ESMA, also showed significant differences in the price charged across different jurisdictions for similar products, more specifically when comparing ratings issued in the EU versus ratings issued in third countries and endorsed in the EU. Prices for endorsed ratings appear typically higher (particularly for the corporate asset class) than those charged for ratings issued in the EU. These variances in the fees charged in different locations for similar products could indicate that fees are based on other aspects rather than costs.

#### ***Transparency and disclosure to the market***

45. The CRAR does not require CRAs to publicly disclose their fee schedules. CRAs should provide to their clients all necessary information (list prices, standard fees or fee ranges for credit ratings and ancillary services) which may help users to compare different CRAs' offerings and facilitate their decision-making process. At the same time, any CRA proposal aimed at increased transparency should remain consistent with the purpose of the CRAR, which is to keep credit analysts independent from the commercial aspect of the rating activity.
46. Another concern related to increased transparency is the risk that sensitive elements of the products/services and the related fees become public for competing CRAs, thus distorting the competitive process and facilitating collusive behaviour. This would be an unintended consequence that would run contrary to the objective of the CRAR on fees, which is to ensure that the fees charged for credit ratings and related services reflect the costs of providing these services rather than other factors, such as competitors' prices.
47. ESMA notes that at least in one other jurisdiction<sup>14</sup> CRAs are required to publish the fee range for the rating services provided, whereas the CRAR is silent on this aspect and does neither set specific obligations nor prohibitions (as opposed to EMIR which mandates Trade Repositories to make their fee schedule publicly available).

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<sup>14</sup> The National Securities Commission (Comisión Nacional de Valores – CNV) of Argentina has instituted a requirement for CRAs to publish the fees they charge, by type of rated instrument/asset class.

### Fee setting and cost monitoring

48. ESMA also requested additional information on cost data from the CRAs. The CRAR establishes that “fees charged to its clients for the provision of credit rating and ancillary services are not discriminatory and are based on actual costs” (Annex I, Section B, point 3c).
49. ESMA identified limitations in CRAs’ cost monitoring practices. Many of the CRAs, especially the larger CRAs, do not monitor costs beyond the asset class level (see Table 1 below). On the other hand, ESMA also identified examples of good monitoring practices, with costs monitored by client, type of product/service and type of cost (e.g. fixed vs. variable costs, direct vs. indirect).

**Table 1: Overview of cost structures across CRAs**

CRA	Breakdown available by			Breakdown by type of costs	
	Asset class	Client	Geographic area	Product / Service	Fixed vs. Variable
CRA1			•		•
CRA2	•				•
CRA3	•				
CRA4	•	•		•	•
CRA5	•				•

Source: ESMA calculations based on CRAs’ responses to ESMA’s request for additional information.

50. The fact that some CRAs only monitor costs at the highest level of aggregation puts into question their ability to demonstrate that fees are cost-based. ESMA considers that the ability to provide a sufficient level of granularity around costs is the starting point in order to ensure that fees charged are based on costs.
51. The lack of cost data also hinders the supervisory process. Supervision of the fees charged by CRAs requires an understanding of the rationale behind any change in fees and in turn, a certain level of granularity in cost reporting.
52. ESMA is concerned that CRAs with significant market power could exploit their market power and margins, which gives them large space for fee flexibility. Costs are not currently the key pricing factor for these CRAs, which ultimately might result in price discrimination.
53. For some rating services, the fees charged to clients appear an estimation of the value for the individual client rather than being linked to the cost of production. For instance, ESMA observed this practice for some products and services provided by entities affiliated to the CRAs, namely with regard to the distribution of credit ratings and related information originating from the CRA (e.g. delivery services of credit ratings, commercialisation of rating content, and the licencing services for the use of credit ratings).
54. The lack of transparency as regards the triggers and nature of costs raises additional supervisory concerns. The impossibility of tracking costs down to individual rating types/asset classes, stemming in part from unsatisfactory cost recording, could result in cross-subsidies between clients. For instance, some structured finance ratings could be



more complex than the traditional credit ratings, as they require an extensive analysis of the various stages/entities involved in the process. At least in theory, the production of ratings of complex financial instruments is expected to be more costly than the production of traditional credit ratings. In this respect, monitoring costs by asset class/rating type can be considered as a good practice.

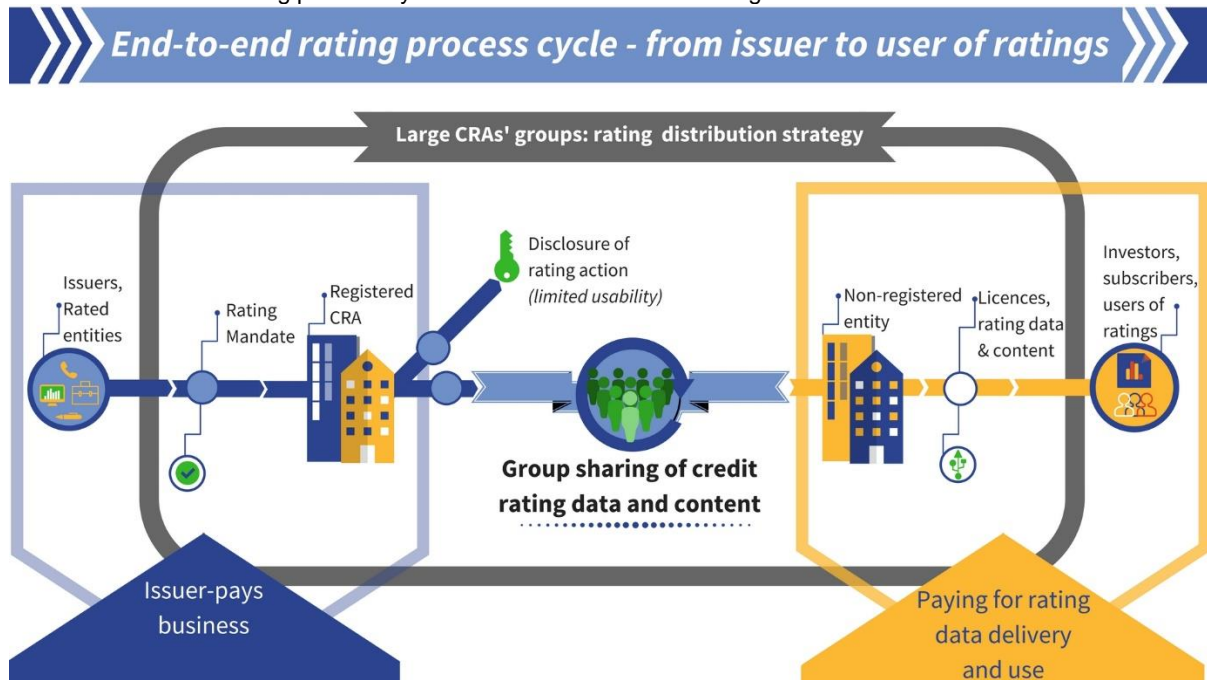
55. ESMA currently does not request costs monitoring data from the CRAs, but in light of these findings, these data will be requested on a periodic basis in the future.

**Credit rating industry and use of credit ratings**

56. The largest CRAs operating globally are part of complex groups which are composed of both rating agencies registered in multiple jurisdictions as well as non-registered entities which are used by the group to distribute and commercialise the rating content produced by the affiliated CRA.

57. Such intragroup business arrangements mean that the end-to-end process for rating and ancillary services (e.g. the process starting with the rating request from a company/issuer and terminating with the distribution of that rating or ancillary services to the ultimate rating users and investors) is split between different entities within the CRA’s group (see simplified process in the next figure). As a result, a significant portion of the business of non-registered entities fully relies on, and is a consequence of, the rating activity conducted by the registered CRA.

**Chart 5: End-to-end rating process cycle – from issuer to user of ratings**



Source: ESMA simplified representation of rating distribution cycle.

58. Most notably, the final stages of this process (i.e. commercialization, distribution, licencing services) are not provided by the CRA itself but by other related entities. This is particularly relevant in the context of the CRAR's provision on fees as those final stages also represent the essential commercial *gateway* used by the group to access and provide to the market rating information and related services.
59. In practice, such a business solution creates a situation where the CRA group could charge their clients both at the beginning of the rating process and at the end of the rating process.<sup>15</sup>
60. A lack of transparency emerges from the fact that issuers, investors and users of ratings are not able to clearly discriminate between the services provided by the registered CRAs as opposed to non-registered affiliated entities. This observation is also highlighted by the IOSCO report on Other CRA Products<sup>16</sup>.
61. Therefore ESMA is concerned about the risks to investors and clients/users of ratings when the distribution by subscription of rating data and information (including pay-for access research or analyses) and the licencing to use rating information for regulatory or other purposes is conducted by non-registered affiliated companies and falls out of any formal control of the registered CRA. In particular, registered CRAs do not exercise any direct control on how rating information and related content are marketed and distributed by affiliated entities (e.g. price, terms of use, agreements and limitations).
62. Nonetheless, investors and users of rating data and rating analysis use such information commercialised by non-registered entities for regulatory purposes (e.g. regulatory reporting, regulatory capital calculation), as well as to take investment decision in their normal course of business.
63. Despite the fact that such services are a *by-product* of the credit rating assessment conducted by the CRA, no related information is reported to ESMA (e.g. fee schedule, or other information on the type of services), which impairs ESMA's ability to properly assess the existence of potential risks associated to the production and distribution of such rating-related services.
64. Moreover, since these activities are a key revenue source of the affiliated entity, and are a consequence of the rating activity performed by the CRA, it raises questions whether the business interests of the group as a whole could have negative implications on the way the CRAs' credit rating activities are conducted, for instance with regard to rating analysts' prioritisation, objectives or workload. It would raise possible conflicts and supervisory concerns if the CRA's core activity of monitoring and reviewing credit ratings was given less relevance or was subordinated to the production of other type of work (e.g.

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<sup>15</sup> IOSCO recently published a report to provide market participants with a better understanding of products and services offered by CRAs and their affiliated entities. See IOSCO report on "Other CRA Products", published on 11 October 2017, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD582.pdf>

<sup>16</sup> IOSCO report on "Other CRA Products" (page 5): "The frequent perception of the users of Other CRA Products is that they are conducting business with the Regulated CRAs, irrespective of which entity issues the Other CRA Product."

reports or papers) that is a revenue generator of the affiliated entity or could attract market attention or media coverage for the whole group.

65. ESMA notes that the cost-based and non-discriminatory principles might not be currently applied to the fees charged for such rating-related products marketed by entities affiliated to the CRA. For instance, purchasers of licences services (e.g. licences which give the right to use the credit ratings for specific purposes such as regulatory purposes, capital calculation, risk management or investor reporting) are critical of the material increase of the charges faced and claim a more than 3-digit fee increase in recent years. They also claim a lack of transparency on the explanation for such increases (which do not appear justified by corresponding additional costs in the service received but rather by the *value* of the service attributed to the individual client), and more generally on the pricing model applied, which is viewed as opaque.
66. Finally, ESMA is concerned that CRA groups' commercial practices result in rating-related revenues being earned by non-registered entities, which might result in the unequal treatment of supervised entities, for instance in the calculation of the supervisory fees as established by Commission Delegation Regulation (EU) 272/2012 (which are based on the reported turnover of registered CRAs but not on the revenues of other entities within their group commercialising the outcome of CRAs' activity)<sup>17</sup>.

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<sup>17</sup> Recital 4 of the Commission Delegated Regulation (EU) No 272/2012 supplementing the CRAR with regard to fees charged by the European Securities and Markets Authority to credit rating agencies states: *"In order to ensure a fair and clear allocation of fees which, at the same time, reflects the actual administrative burden per supervised entity, the supervisory fee should be calculated according to the credit rating agencies' turnover, generated from rating activities and ancillary services, since the cost of supervision is higher for larger credit rating agencies than for smaller ones. Moreover, the provision of ancillary services requires additional supervisory effort as possible conflicts of interests resulting from the provision of ancillary services need monitoring. Credit rating agencies should not circumvent the fair allocation of fees according to this Regulation by reallocating revenue to other entities within their group in order to reduce their fee contributions. ESMA should monitor and report any critical developments in this respect."*

## ESMA's supervisory approach and next steps

### **Transparency and disclosure**

67. Transparency is crucial for enabling CRAs' clients to make informed choices. Transparency is also fundamental for supporting non-discriminatory fee practices and preventing arbitrary pricing.
68. ESMA aims at enhancing the level of CRAs' transparency to the market and their clients. In particular, ESMA aims at increasing clients' understanding of what CRAs charge them, pursuing more clarity around the fee schedules and reasons for deviations from it.
69. ESMA also intends to engage with clients to enhance its understanding of their choice of CRA, develop further insights on how clients experience the level of transparency of fee schedule and promote more informed decision-making.
70. ESMA notes that at least in one other jurisdiction CRAs are required to publish the fee range for the rating services provided, although the CRAR is silent on this aspect and does neither set specific obligations nor prohibitions (as opposed to EMIR which mandates Trade Repositories to make their fee schedule publicly available).
71. ESMA also acknowledges that increased market disclosure by the CRA, while feasible, would need to be carefully calibrated as it may have both *pros* (e.g. facilitate fee comparison by clients; increase public scrutiny) as well as *cons* (e.g. possible risks to the independence of the rating analysts should they become aware of sensitive fee information on the rated entities; risk of distorting the competitive process and facilitating collusive behaviour due to disclosure of sensitive information). Nonetheless, CRAs should consider disclosing such fee range as included in their fee schedule (if not the fee schedule itself) bilaterally to their existing or potential clients. This would reduce the information gap between the two parties hence reducing the space for extensive price negotiation and excessive deviation.
72. CRAs should also provide clarity to their clients on the reasons underlying material changes to the fee charged. As an example, CRAs should clarify when legacy pricing or discounts made in the past (for instance, to allow market entry) are discontinued and prices are changed in order to be aligned to the current fee schedule.
73. ESMA also sees opportunity for significant enhancement of CRA's internal controls (e.g. compliance and internal audit) around the fee setting process and application, for instance with regard to material and/or continuous deviation from the fee schedule.
74. ESMA also encourages market players to proactively engage with ESMA when they have concerns on possible arbitrary pricing for the rating services they purchase. In order to achieve increased transparency, it is equally important that purchasers of rating services challenge, require information and actively seek clarity from the rating service providers when they do not have sufficient understanding of the basis of the fees they are charged.

75. There is a need to enhance data reporting to ESMA to allow for supervision that is more effective.

76. Overall, the considerations provided in the previous sections highlight how the information currently available to ESMA does not sufficiently enable ESMA to effectively supervise how CRAs comply with the fee-related regulatory requirements. ESMA does not have sufficient information in relation to CRAs' costs, deviations from fee schedules/programme or rating-related services provided by affiliated entities.

77. ESMA will therefore consider the possibility of enhancing the periodic information and notification it receives from CRAs to address the information gap (e.g. information on the costs used in the fee setting process, material deviation of fees charged, material changes to fee schedule, information on group-wide rating-related products and services), for instance through the revision of ESMA's guidelines on periodic information. ESMA may as well consider the possibility to revise the Delegated Regulation on Fee (e.g. possible inclusions of group-wide revenues generated by the rating-related activities performed by the CRAs).

### ***Fee setting and cost monitoring***

78. Thorough cost recording and monitoring is crucial to ensure cost-based pricing. Weak cost monitoring impairs the ability to use cost information for setting fair and reasonable fees and ensure cost-based fees.

79. ESMA aims at enhancing CRAs' cost recording and monitoring practices. A good practice is to monitor costs in a way which is reflective of the fees structure put in place, recognising direct versus indirect, fixed versus variable, as well as tangible versus intangible costs in connection to the individual fee schedules or fee programmes (e.g. by type of service, product or asset class; by geography). This would support the use of cost information in a practical and meaningful way during the fee setting process and assist in establishing fees based on costs.

80. ESMA acknowledges that other elements may also influence the fee schedule or fee programme established for a given product or service (e.g. strategy, profit targets, expansion in existing or new markets). However, such considerations do not exempt CRAs from establishing a price setting process that ensures fees are based on costs, or from providing evidence to ESMA on how the regulatory requirements are met. A very high level of cost aggregation, not reflective of the fee structure, does not meet ESMA's expectations and does not provide sufficient evidence of costs being a key factor of price setting.

81. ESMA expects that in order to support cost-based and non-discriminatory fees, CRAs should ensure as a minimum the following standards:

- a) **Costs are a key pricing factor**, which means that the fees are based on costs and not the value for the client or other elements which could result in discriminatory pricing.

- b) **Ability to break down and monitor costs** in a way that ensures cost information is effectively taken into consideration during the fee setting process.
- c) **Regular review and controls.** CRAs should ensure regular review and establish controls around costs and their relation to fees, as well as on the deviations between actual prices charged and fee schedules, to ensure cost-related fees and non-discriminatory prices.

### ***Credit rating industry and use of credit ratings***

82. The provision of credit rating-related services (e.g. distribution of rating content, delivery services and licensing services for the use of credit ratings) by entities affiliated to the registered CRA issuing those credit ratings poses additional challenges to investor protection, transparency and disclosure.

- 83. ESMA is concerned with the business practices and relationship between registered CRAs and their affiliated entities that provide the financial market with credit-rating information originated from the CRA, including distribution services of credit rating and rating content and the licencing services for the use of credit ratings.
- 84. ESMA is concerned about the risks to investors and clients/users of ratings when the distribution by subscription of rating data and information (including pay-for access research or analysis) and the licencing to use rating information for regulatory or other purposes is conducted by non-registered affiliated companies and falls out of any formal control of the CRA. In particular, CRAs do not exercise any direct control on how rating information and related content are used, marketed and distributed by affiliated entities (e.g. price, terms of use, agreements and limitations).
- 85. ESMA notes that users of credit rating reports and analysis are not able to discriminate between the credit rating report produced under the remit of the CRAR (hence meeting all the relevant regulatory requirements) as opposed to other types of analysis or reports which are not produced for regulatory purpose, despite being commercialised by the same group the CRA belongs to.
- 86. ESMA is also concerned by the possible conflicts affecting the quality and the independence of rating analysis when CRAs analysts' activity is not fully focused on the issuance and monitoring of credit ratings, but also on producing additional services which are a significant revenue generator for entities affiliated to the CRA.
- 87. ESMA has limited information on such additional activities, also due to limited disclosure by CRAs. ESMA acknowledges that this area merits further review to properly assess the existence of potential risks which could impair the objectives of ESMA as well as of the CRAR.
- 88. As a general principle, ESMA considers it good practice to ensure that the same policies, procedures and controls (including compliance oversight) apply to all rating products and rating content originated by the CRA. The above principle should be applied independently

from the commercial arrangements established within the CRAs' groups, i.e. whether such products or content ultimately reach the financial markets, investors and user directly through the CRA or through their affiliated entities.

89. ESMA aims at enhancing its knowledge and relevant information on such rating-related products and services provided by the CRAs' groups as a whole, specifically when these products and services rely on the resources (including analysts) of the registered CRA. ESMA will therefore request on an ad-hoc or periodic basis the submission of relevant information from CRAs and related parties, as well as from investors and users of ratings.
90. Overall, ESMA aims at gaining sufficient clarity on the rating-related activities that could raise risks to its objectives. At the same time, ESMA acknowledges that this is an area where clarity might be needed for both CRAs and other market participants. ESMA will explore what alternative options can be pursued to enhance clarity, including possible referral or advice to the European Commission.

### 3 TR Industry practices – key findings, concerns and supervisory approach

#### *Industry dynamics, competition environment and TRs' practices*

91. TRs are a new type of market infrastructure in Europe, registered and supervised by ESMA since end 2013. The core function of TRs is to collect the records of derivatives and make them available to regulatory authorities.
92. The introduction of TRs came with EMIR, which was the European response to the G20 commitment to reform financial markets after the crisis, introducing a new market framework for the derivatives business, in order to reduce systemic risk and to increase market transparency.
93. EMIR brought a new business opportunity for bigger market players already owning FMIs and offering post-trading services in their group, for example those already offering TR services in other jurisdictions or those owning a central counterparty (CCP) or an exchange. In this respect, setting up an EU TR was a strategic step for the big market players to offer a complete package of services to clients, including external market participants or intra group companies.
94. The table below shows that most TRs currently registered in the EU are effectively part of global market players offering additional services:

**Table 2:** EU registered TRs and their ownership as of January 2018

EU registered TR	The ultimate owner(s)
<b>Bloomberg Trade Repository Limited</b>	Bloomberg LP, US
<b>CME Trade Repository Ltd. (CME TR)</b>	CME Group Inc., US
<b>DTCC Derivatives Repository Ltd. (DDRL)</b>	The Depository Trust & Clearing Corporation (DTCC), US
<b>ICE Trade Vault Europe Ltd. (ICE TVEL)</b>	Intercontinental Exchange, Inc. (US)
<b>Krajowy Depozyt Papierów Wartościowych S.A. (KDPW)</b>	National Bank of Poland (NBP), Ministry of Treasury of Poland (MSP), Warsaw Stock Exchange (GPW)
<b>NEX Abide Trade Repository AB</b>	NEX group PLC (UK)
<b>Regis-TR S.A.</b>	BME (ES) and DBAG (DE)
<b>Unavista Limited</b>	London Stock Exchange Group PLC, UK

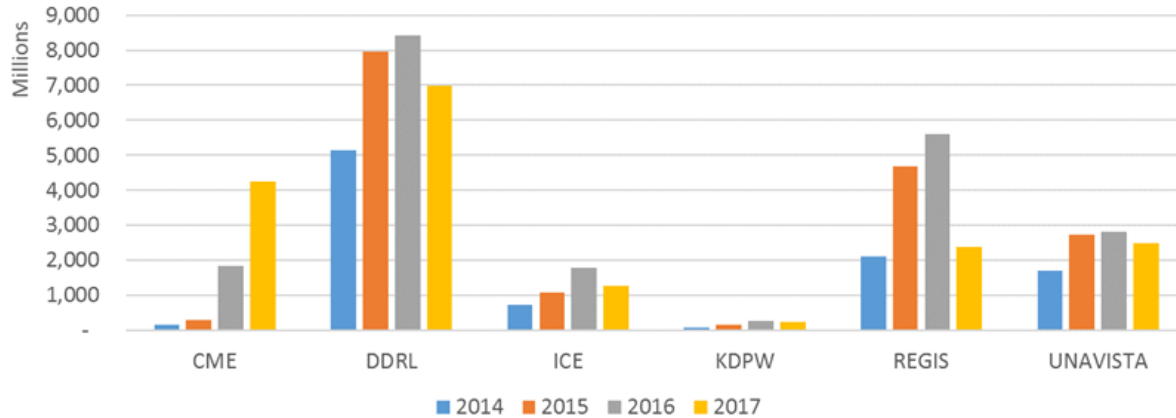
Source: ESMA's elaboration based on TR registration information.

95. Under EMIR, EU counterparties to a derivative transaction became subject to a trade reporting obligation from February 2014 onwards. Counterparties can fulfil this obligation by reporting, directly or through an intermediary, their derivative contracts to one of the



registered TRs. The below graph demonstrates that out of 6 TRs fully operational since 2014<sup>18</sup>, DDRL was the biggest TR in terms of reports collected from the clients.

**Chart 6:** Number of reports received so far as of October 2017



Source: ESMA calculations based on weekly statistics provided by the TRs.

96. Reporting to a TR implies additional trading costs for market participants. Being for-profit organisations, TRs charge fees for their services. As already explained in the previous section, the fees of TRs need to meet certain requirements of EMIR, namely that prices and fees are publicly disclosed and cost-related. This should help clients to select a TR that best suits their needs and ensure that costs are a key pricing factor. In addition, under EMIR, access to TR services should not be discriminatory and all types of clients should have equal conditions of access to TR services.
97. Essentially, there are two main types of clients who contract with TRs for reporting purposes: counterparties reporting on behalf of themselves directly and entities to whom counterparties have delegated their reporting. This is because under EMIR a counterparty or a CCP, which is subject to the reporting obligation, is allowed to delegate the reporting of the details of the derivative contract instead of reporting directly.
98. The extent of delegated reporting is large across all the TRs. In 2016, TRs had only 4,705 clients contracted with TRs directly whereas in total there were around 600,000 counterparties reporting to TRs in Europe. This may be explained by the uniqueness of the EU reporting regime compared to other jurisdictions as under EMIR it is required that both parties to a derivative contract report to a TR whereas in other jurisdictions the reporting is single-sided.
99. All TRs have published their fee schedules on their websites since registration. Certain TRs have adjusted their fee schedules in the past years. These changes can be attributed to several reasons, including increased costs for certain types of clients or reporting patterns or low profitability. Some TRs already took the opportunity to revise their fee

<sup>18</sup> Bloomberg Trade Repository Limited was registered in June 2017; NEX Abide Trade Repository AB was registered in November 2017

schedules taking into account the direction of this thematic review, which was discussed with TRs during a dedicated Roundtable organised at ESMA in June 2017.

100. The approach that TRs have taken to structure their respective fee schedules differs, making it difficult to make a straightforward comparison of fees across TRs. For example, the starting point for all TRs is a reporting fee, however the final fee is determined by additional factors such as client type, and number of contracts reported that are specific per TR.
101. While reporting fee does not give a complete picture of the full price, the table below provides an indicative overview of the minimum fees applied across TRs:

**Table 3:** Indicative summary of some types of TR fees indicated in their fee schedules (EUR)

TR		TR1	TR2	TR3	TR4	TR5	TR6	TR7
Annual Membership fee / Access fee /Minimum fee <sup>19</sup>		1,800	4,100	325	1,700	460	6,000	2,300
Reporting fee <sup>20, 21</sup>	ETD	0.032	0.006	0.029	0.01	0.011	0.0001	0.000097
	OTC	0.068	0.15	0.45	1.6E-11	0.034	0.0001	0.000097

Source: ESMA elaboration based on TRs' publicly available fee schedules as of October 2017.

102. From Table 3 it is evident that reporting fees are relatively low (expressed in decimals) but there are quite substantial differences across TRs in annual membership fees, access fees or minimum fees. In particular, the reporting fees start to make a difference in the case of large reporting volumes and additional factors such as capped fees, volume band, client type, reporting type and others need to be taken into account. For more detailed and complete information, one should refer to the fee schedules of individual TRs.
103. Through the interactions with the reporting industry and TRs, ESMA understands that the reporting fee itself is not the sole factor behind a client's decision to choose a TR. Other factors - such as selecting a TR to which the other counterparty reports, a TR that is large enough and has many users (some clients associates this with stability), a TR that covers a certain market or jurisdiction, a level of integration with other service providers, investment needed to establish a connection – are all equally important to clients.

<sup>19</sup> TRs have different approaches on whether to charge membership and maintenance fee or whether to introduce a minimum fee that usually contains some number of trades that can be reported free of charge.

<sup>20</sup> The basis for the calculation of reporting fees differs per TR and could refer to either new trades (UTIs) or positions.

<sup>21</sup> Where different rates are applicable (i.e. expressed depending on the volume of trades/positions submitted during certain period, or depending on asset class) the minimum amount has been considered, for illustrative purposes.

### *Key findings and ESMA's areas of concerns*

104. As part of the thematic review, ESMA looked at whether publicly available information on TR fees is sufficient to support an informed decision by counterparties and how TRs implement EMIR requirements for fees. As part of this, ESMA has also engaged with TRs and users of TR services.
105. ESMA has identified transparency and cost-related TR fees as the two key areas of focus in ESMA's approach to the supervision of fees charged by TRs.

### **Transparency**

106. ESMA observed that all the TRs publish their fee schedules on their websites and formally meet the obligation to disclose prices and fees associated with services provided under EMIR. Every interested client may access the TR fee schedules on their websites. During the review, ESMA focused on the: a) clarity, b) comparability, c) consistency and d) comprehensiveness of the TR fee schedules.

#### **a) Clarity**

107. ESMA observed that each TR applies a unique fee schedule. For example, TRs are using a different basis for the fees they charge. Some TRs charge per Unique Trade Identifier (UTI), some have different pricing for reporting an Over the counter (OTC) derivative or an Exchange traded derivative (ETD), some charge OTC trades per position and ETD trades per transaction and one TR considers quantity, the quantity or notional units (for FX and Commodities asset classes), and the notional value. TRs have also taken different approaches to volume bands (if any) and different fee caps per type of client.
108. While EMIR does not require standard fee schedules from TRs, the differences across fees should nonetheless not limit usefulness of fee schedules for counterparties. ESMA observed that the level of detail provided in many of the schedules might not be sufficient to allow a counterparty to make an informed assessment and decide which TR best suits its needs based on estimations, especially if a counterparty is a small and less experienced firm.
109. ESMA analysed whether TR fee schedules are easily understandable for counterparties considering that the EMIR regime is still developing in Europe and, unlike other jurisdictions, the derivatives contracts need to be reported by both sides of the derivatives contract, even if one side is a small financial firm. The trade associations that ESMA interacted with throughout the TR fees review confirmed that more detailed information and explanation in TR fee schedules would be useful. In ESMA's view, fee schedules that are accompanied by more explanatory information, such as specific examples of fee calculation for certain reporting scenarios could significantly help small counterparties and allow them to make estimations that are more precise on their reporting costs.
110. ESMA notes that some TRs have already included several examples in their fee schedules prior to the publication of this report. Some TRs took the initiative to enhance the clarity of

the explanatory material included in their fee schedules in the course of the review. Overall, TRs seem to be willing to enhance the clarity of their fee schedules and reduce the time spent explaining how their fees work to individual clients, who not only try to estimate their fees but also want to better understand their reporting obligations.

111. ESMA believes that further enhancements to TR fees schedules, such as adding illustrative examples for the most popular reporting scenarios would not only increase the transparency of TR fees but would also provide a balance between the publicly available information and individual advice on TR prices and fees associated with the services under EMIR.

### ***b) Comparability***

112. ESMA has observed that even when differences in the TR fee schedules are clear, the straightforward comparison requires effort due to the differing approaches taken by TRs to structure their fees.
113. The obligation to publicly disclose fees is also related to CPMI IOSCO<sup>22</sup> Principle 23, which states that clear descriptions of priced services are important for comparability purposes. Publicly disclosed fees empower clients to make an informed choice by comparing the price of using services of one or another TR.
114. Trade associations have also shared that some clients themselves build internal automated fee calculators on the basis of the fee schedule of the TR they report to, in order to verify the invoices issued by TRs or to estimate future fees.
115. Based on the information collected during ESMA's review, at least two TRs make automated fee calculators available to prospective clients upon request. ESMA identifies as good practice the use of on-line calculators to enhance comparability between TRs for clients.

### ***c) Consistency***

116. Although TRs offer similar services, they tend to label the services differently and classify clients differently in ways that do not always correspond across TRs.
117. For example, one TR's fee schedule refers to "standard" and "value" users, the other differentiates among reporting participants, external third parties, internal third parties and non-reporting participants, whereas another TR provides separate fees for Clearing firms, CCPs, Exchanges and other participants.
118. As a result, a client cannot easily identify into which category it would fall in every TR and some terms applicable in one TR may be misleading if applied in another TR. Therefore, ESMA identifies it as a good practice when TRs aim to use definitions that have common

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<sup>22</sup> The Committee of Payments and Market Infrastructure of the International Organization of Securities Commissions

understanding in the industry, that are simple, not subjective, consistent and their meaning is explained in plain language.

#### **d) Comprehensiveness**

119. TR fee schedules do not disclose any additional information on technology and communication procedures that may affect the costs to the client. ESMA has observed that one TR is offering connectivity services via another entity within the group for which the client can be charged separately, but this was not indicated in the publicly disclosed fees schedule. In ESMA's view, transparency around potential connectivity costs would help clients in evaluating the total cost of using a particular TR.
120. Article 78(7) of EMIR requires TRs to have objective, non-discriminatory and publicly disclosed requirements for access by undertakings subject to the reporting obligation under Article 9. The need to make this information available also reflects CPMI IOSCO Principle 23 which states that FMI should disclose information on the system design, as well as technology and communication procedures, that affect the costs of operating the FMI. These disclosures collectively help participants to evaluate the total cost of using a particular service, compare these costs to those of alternative arrangements, and select only the services that they wish to use.
121. TRs and market participants (trade associations) have stated to ESMA that the costs of establishing a reporting solution and connectivity to a TR are important for clients. The need to re-invest in such solutions that cannot be easily adapted to other TRs may prevent clients from deciding to move from one TR to another.
122. While the system requirements of TRs is beyond the scope of this report, one area that requires further insight is how market participants connect with a TR and the associated costs related to reporting to a TR. As mentioned previously, access to TRs is required to be non-discriminatory. TRs could deny access to particular types of market participants by requiring prohibitively high connectivity costs.
123. In ESMA's view, for transparency purposes and in order to enable clients to evaluate and compare the total costs of reporting for different TRs, information on TR system design and connectivity requirements should be easily accessible and clear as it may affect the cost to a client to establish a connection and a reporting mechanism to a TR.

#### **Cost-related TR fees**

124. EMIR requires TR fees to be cost-related. As already explained in Section 1, the term "cost-related" can be closely linked to "cost-based", which means that the key pricing factor is costs. In ESMA's view, ensuring cost-related fees is important for several reasons.
125. EMIR imposed a reporting obligation and a requirement to directly or indirectly (by delegation) use reporting services of a TR. Counterparties subject to the reporting obligation cannot avoid their obligation and the EMIR requirement for TRs to charge cost-related fees acts as a preventative measure to avoid value or demand based pricing, which can result in high margins or distortion of competition.

126. Cost-related pricing also links with PFMI principle 21, which highlights the importance of cost control for efficiency purposes. In particular, it prescribes that an FMI should establish mechanisms for the regular review of its efficiency, including its costs and pricing structure. The focus on costs and pricing structure in the form of regular reviews, assessments and future projections (monitoring and control) increases the efficiency of TRs and ultimately benefits the market that TRs serve.
127. Finally, cost-related fees help to prevent discriminatory practices such as adjusting fees to specific client types. This is particularly important given that in some cases the clients of TRs are affiliated companies and cost-related fees ensure that they are not treated differently, i.e. lower fees are justified by lower costs.

### **TR cost monitoring**

128. Based on the fee schedules of TRs, the core service of collecting the derivatives records under EMIR is typically broken down into direct reporting (when counterparties report on their own), delegated reporting (when counterparties delegate their reporting to the other parties), and view-only access (when counterparty is not reporting but may view the information reported on its behalf). These categories differ slightly across TRs, but the principle is the same and these categories are charged differently.
129. Some TRs go into further detail and differentiate the fees depending on the derivative type, asset class of underlying product and even notional amount whereas others keep a simplistic approach and charge for UTIs only.
130. ESMA did not observe consistent efforts of TRs to establish the fees in relation to costs, to fully consider all operational costs, i.e. direct (expenses that a company can easily connect to a specific cost object) and to the extent possible indirect costs that go beyond the costs associated with a particular service. In addition, ESMA did not see consistent practices of TRs in making cost estimations based on either fixed costs or on the variable costs that vary depending on the volumes (economies of scale).
131. Irrespective of the approaches that ESMA has observed in TRs, ESMA has found that TRs are not assessing costs per separate service<sup>23</sup> indicated in the fee schedule, but rather identify the overall cost of providing core TR services under EMIR.
132. In the context of the requirement for the fees to be cost-related, this practice raises several concerns.
133. ESMA believes that when TRs are not able to estimate the costs of providing different services under EMIR it may prevent them from charging cost-related fees. For example, if a TR decides to charge differently ETD and OTC derivative reporting, Commodity or Credit derivative swap, ESMA would expect that the reason of the difference is primarily based on costs.

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<sup>23</sup> By the term "service" ESMA refers to any product that is listed in TR Fee schedule and that has a separately assigned price.

134. Through the discussions with TRs, ESMA understands that detailed cost breakdown at the lowest level of services, while technically feasible, may be disproportionately resource consuming, especially when we refer to fees expressed in decimals.
135. Although ESMA views cost breakdowns at the lowest service level as a good practice, this does not prevent TRs from exploring other methods to demonstrate that the decision to price certain services differently was based on costs and not only on strategic or practical reasons.
136. The ability to account for the costs at more detailed level is also important in cases where a TR offers or intends to offer ancillary services. Providing core TR and ancillary services may require similar resources and identifying the costs of these resources separately is crucial.
137. In some instances, due to the particularities of the TR industry, it may happen that fees of TRs are not sufficient to cover the costs. For example, due to sharp changes in costs or client base. The time required to come up with new pricing structure, notify ESMA, existing and prospective clients may result in temporary prices below cost.
138. On the other hand, deliberate decisions of TRs to price services below costs (for example because of introductory offers or market testing) would raise supervisory concerns to ESMA as to how these decisions ensure cost-related fees. Moreover, such decisions can result in unfair competition because as soon as a client selects a TR and engages with it based on certain conditions it might not be that easy for this client to switch to another TR after conditions change. In addition, fees below cost pose a risk to TR financial viability.
139. The recently published ESMA Guidelines on transfer of data between trade repositories (Portability Guidelines)<sup>24</sup> support a competitive environment for TRs as they establish a consistent and harmonised process to transfer records from one TR to another TR and can be applied if a client decides to switch its reporting from one TR to another. However, ESMA recognises that the additional on-boarding costs when choosing a different TR may make switching between TRs too expensive for some users of TR services. It may take time and resources for clients to establish a connection to another TR. For this reason, the new Portability Guidelines can facilitate a competitive environment in the market for TRs only if the fees are transparent and cost-related.

### ***TRs as part of groups***

140. Certain TRs have clients that belong to the same group as the TR and that report significant amounts of trades to the TR (See Chart 7). In some cases, the total fees charged to affiliates seem to be disproportionate with respect to the underlying volumes reported (See Chart 8).
141. For example, more than 90 per cent of the total volume of transactions reported to TR1

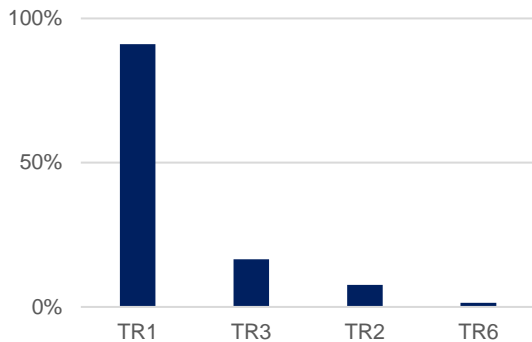
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<sup>24</sup> 24 August 2017 ESMA70-151-552, [https://www.esma.europa.eu/sites/default/files/library/esma70-151-552\\_guidelines\\_on\\_transfer\\_of\\_data\\_between\\_trade\\_repositories.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-151-552_guidelines_on_transfer_of_data_between_trade_repositories.pdf)

has been reported by entities from the same group. At the same time, the revenues collected by TR1 from affiliates is roughly 22 per cent of total revenues.

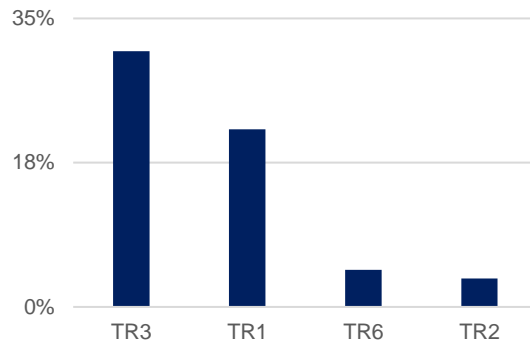
142. An opposite example is TR3, which derives almost 31 per cent of its revenues from transactions reported by entities from the group, for a volume of transactions that accounts for approximately 16 per cent of the total volume.

**Chart 7:** Ratio of volume of trades reported to TR by group affiliates vs. total volume, 2016



Note: The figures for TR4, TR5 and TR7 are not available.  
Source: ESMA calculations based on TRs' responses to ESMA's request for additional information.

**Chart 8:** Ratio of group fees to total revenues, 2016



Note: The figures for TR4, TR5 and TR7 are not available.  
Source: ESMA calculations based on TRs' responses to ESMA's request for additional information.

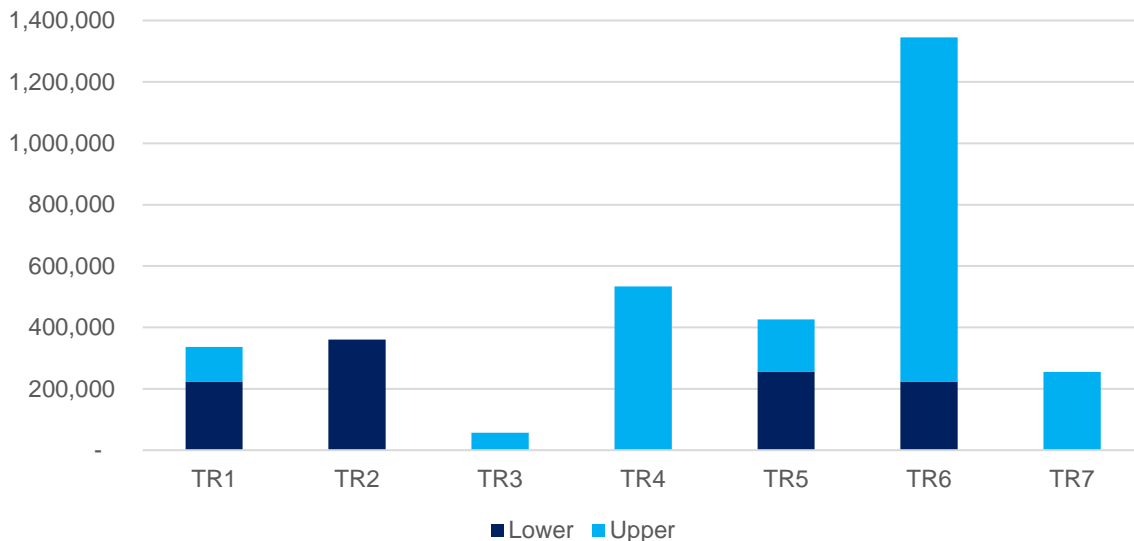
143. The above examples show how important it is to set cost-related fees when TR affiliates also use TR services. The situation where the revenues from affiliates are significantly lower than the share of volumes reported by these affiliates means that other non-affiliated clients pay more even if their volumes are lower. ESMA understands that the situation could be partially explained by economies of scale, at the same time it raises concerns whether the fees are indeed based on costs and non-discriminatory, i.e. not benefitting specific types of clients, such as affiliated companies.
144. ESMA acknowledges that TRs are FMI's requiring significant technology costs and investments in order to maintain their operations. Due to the nature of their business, TRs would not be able to remain financially viable in the absence of group support and experience. Outsourcing arrangements and intra group agreements set out the conditions on which costs are passed to the TR.
145. This being the case, TRs which are part of a group may also receive significant group support and carry fewer costs, and as a consequence may be able to charge lower fees. However, the benefits of this dynamic to the users needs to be balanced with the risk of creating barriers to new entrants or disadvantaging existing market players that do not have the same level of group support.
146. As a principle, ESMA believes that intra group transactions based on reasonable terms and on an arm's-length principle prevent the above mentioned risks, discriminatory access to affiliates and unfair cost allocation, from materialising.



### Pricing of high volume reporting - fee caps

147. ESMA observed that every TR has a fee cap and/or volume tiers in place. Fee caps enable entities that report significant volumes of trades to limit TR fees after reaching a certain volume of trades in a given period. The chart below demonstrates the differences of annual fee caps applied by TRs:

**Chart 9:** Fee caps by TR, EUR, 2017<sup>25</sup>



Source: TR fee schedules, October 2017.

148. Through the discussions with TRs, ESMA understood that by setting fee caps TRs seek to reflect economies of scale, remain competitive and/or to help large clients to plan their costs. However, ESMA has not seen consistent efforts from TRs to assess and ensure that fee caps are related to costs and that they are not discriminatory, i.e. not benefiting only specific type of clients.

149. As part of the TR schedules' comparability test, ESMA conducted a comparative analysis of some TRs fee schedules at the end of 2016. ESMA used the following volumes of clients and applied them across each of the six TRs to attain a theoretical fee:

- a) Most active client (requested directly from each TR);
- b) Average volume (inferred from weekly statistics submitted to ESMA by each TR); and
- c) A chosen separate figure to allow comparability of varying volumes derived from the distribution of derivatives classes. This figure could be lowered or raised to allow for counterparties reporting different quantities.

150. During the exercise, prices were broken down by OTC, ETD, and asset class for each TR, but these splits were not applicable to the pricing schedules for every TR. The comparison

<sup>25</sup> For more detailed and complete information, one should refer to the fee schedules of individual TRs.

exercise illustrated the differences across fee schedules. Some TRs would theoretically charge many times the fees of those charged by other TRs if the fee schedules were strictly applied and fee caps were not applied.

151. In the course of the review ESMA asked TRs to estimate the difference between actual revenues received from the clients above the fee cap and revenues that could have been received if the fee caps were not in place. The figures provided varied significantly. In the context of cost monitoring at overall TR services level this raises concerns on whether the revenues, which could have been received from the clients who reached the fee cap may in fact have been charged to other clients.
152. Furthermore, ESMA observed that fee caps are reached only by a few clients of TRs (43 clients in total across all TRs were subject to a fee cap in 2016) and that these clients are reporting on behalf of other counterparties. The fact that a fee cap is applied to a relatively small population of TR clients may suggest a risk that fees are not being applied in a non-discriminatory manner.
153. In addition, ESMA observed that fee caps in certain cases are applied to clients that belong to the same group as the TR itself. This is particularly the case for those TRs that have large clients in the same group. More clarity and transparency in relation to costs would ensure that the fee caps are not tailored to benefit affiliated companies only.
154. In the course of the review, ESMA observed that not all TRs could easily identify the number of underlying clients of delegated reporting service providers actually sending the reports to TRs. It was difficult for TRs to identify the volumes attributable to each of the underlying clients. This means that the fee caps of some TRs were set up in a way that disregarded the type, size and activity of underlying clients. As a result, the same fee could have been applied to an intermediary reporting on behalf of several big banks and a service provider reporting on behalf of smaller firms. This raises concerns of potentially discriminatory practices in price setting. ESMA notes that some TRs have recently started adjusting their fees caps so that they are more reflective of the actual structure of the reporting entity subject to fee cap/volume tiers.
155. ESMA expects that TRs carefully analyse and assess the risks stemming from fee caps as a minimum by regularly monitoring and assessing the impact of fee caps and volume tiers, clearly identifying their relation to costs, considering the type of the reporting entity and its underlying clients and being careful not to create discriminatory conditions.

## *ESMA's supervisory approach and next steps*

### ***Transparency***

156. ESMA believes that sufficient transparency can be achieved via clear, comparable, consistent and comprehensive fee schedules that enable a client to estimate its total costs of reporting to a TR.
157. In ESMA's view, the empowerment of current and prospective TR clients can be achieved by increasing the transparency of TR fees. Fee schedules amended with explanations and examples that are more detailed would ensure greater clarity for clients, and enable a comparison with the price of similar services provided by other TRs. Furthermore, ESMA encourages the use of consistent definitions across TRs to reduce the complexity of fee schedules. Disclosing information relevant to estimate any additional reporting costs for a client would help in preventing discriminatory practices and benefit competition.
158. ESMA considers that the level of transparency of TR fee schedules can be measured using the following characteristics ("4C principles"):
- a) **Clear.** A fee schedule is clear when it is simple, understandable and contains explanatory examples; the differences across TR fees are not limiting their clarity for counterparties.
  - b) **Comparable.** A fee schedule is comparable when it is possible to draw a parallel of the prices of services of one TR with the prices of services of other TR either through practical examples, or through on-line calculators.
  - c) **Consistent.** A fee schedule is consistent when it uses definitions that have common understanding in the industry, that are simple, consistent and their meaning is explained in plain language.
  - d) **Comprehensive/complete.** A fee schedule is comprehensive when it contains all the information that is necessary for a client to estimate its reporting cost, including establishment of access and connection.
159. Overall, ESMA aims at increasing transparency and usefulness of information provided in TR fee schedules. ESMA acknowledges that some objectives, such as increasing comparability and using consistent definitions in the fee schedules requires an aligned approach across TRs. ESMA will therefore explore whether further guidance on establishing key concepts and definitions to be used in TR fee schedules may be helpful.

### ***Fee setting and cost monitoring***

160. It is important to ensure that TRs' decisions on price setting are based not only on strategic and/or practical considerations. ESMA expects that TRs are able to demonstrate that their fees, including fee caps, are driven by costs.
161. The review of TR pricing and cost monitoring practices suggests that there could be more efforts from TRs to ensure cost-related fees. The current situation where costs are monitored at a highly aggregated level and decisions to set fee caps do not seem to be driven by costs raises the risk of potential discriminatory practices that are against EMIR requirements.
162. ESMA expects that in order to be able to demonstrate that the fees are cost-related, TRs set their fees in line with the following principles:
- a) **Costs are a key pricing factor.** It means that the fees are based on costs and not the value for the client or to market situation (such principle would be equally applicable to fee caps).
  - b) It is good practice if TRs are able to **break-down costs** to the lowest level of services. ESMA also encourages TRs to explore other alternatives that can demonstrate that the decision to price certain services differently was based on costs and not only on strategic or practical reasons.
  - c) **Regular review.** Costs and their relation to fees should be regularly reviewed to ensure cost-related fees and non-discriminatory prices for any type of participant.
  - d) **Intra-group transactions** based on reasonable terms and on an arm's-length principle ensure a level playing field and prevent unfair cost allocation between a TR and the group companies.
163. ESMA expects that when TRs make pricing decisions based on the aforementioned principles, they also take into consideration the effect of such decisions to other EMIR requirements. In particular, cost-related fees should not create barrier to access reporting services under EMIR, for example for smaller firms.

## Annex 1 - Legal background

1. The legal framework of the current Report is formed by the following provisions of the CRA Regulation (CRAR) and the European Market Infrastructure Regulation (EMIR) that set out the requirements for CRAs and TRs on how they should charge their clients:
  - CRAs shall ensure that fees charged to their clients for the provision of credit rating and ancillary services are not discriminatory and based on actual costs. (CRAR, Annex I, Section B, 3c).
  - Access to TRs shall be non-discriminatory and fees charged by TRs shall be publicly disclosed and cost-related. (EMIR, Art. 78).
2. These provisions (hereafter “fee provisions”) intend to establish essential operational conditions for CRAs and TRs regarding the fees charged to their clients, protect against conflict of interest, empower CRAs/TRs clients affected by the fees charged, and promote a level playing field in the market.
3. The fee provisions equally establish ESMA’s role and powers in fee supervision and require ESMA to supervise the provision of credit ratings and ancillary services.
4. For CRAs the fee provision should be interpreted in combination with the following regulatory requirements:
  - 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 clients 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 clients. Moreover, the fees charged for credit 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. (Recital 38 of Regulation (EU) No 462/2013 of the European Parliament and Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies);
  - Independence of analytical activities from commercial activities and business interests (CRAR, Art. 6);
  - Provision of ancillary services does not present conflicts of interest with the credit rating activities (CRAR, Annex I, Section B 4);
  - The fees charged to each client for individual credit ratings and any ancillary services and the pricing policy, including the fees structure and pricing criteria are reportable to ESMA (CRAR, Art. 11(3)); and

- Some financial information on the revenue, including total turnover, divided into fees from credit rating and ancillary services should be disclosed through Transparency Report (CRAR, Annex I, Section E III (Transparency report) 7).
5. As to EMIR, in addition to the fee provisions of article 78 , the following requirement is also relevant for defining criteria of price setting:
    - TRs should keep their ancillary services operationally separate from their core function (EMIR, Art. 78(5)).
  6. The fee provisions are to be interpreted in conjunction with the overriding objectives of CRAR and EMIR to enhance investor protection; promote stable and orderly financial markets and fair competition; ensure transparency, integrity and quality of services and prevent conflict of interest. In addition, in its supervision ESMA applies a risk-based approach.

## Annex 2 – Fact-sheet

# Fees charged by Credit Rating Agencies and Trade Repositories

**FACT SHEET**  
on the Thematic Report

Key observations and areas of supervisory focus



## Credit Rating Agencies

Area	Transparency and disclosure	Fee setting and cost monitoring	Credit rating industry and use of credit ratings
Supervisory Focus	<ul style="list-style-type: none"> <li>✓ Sufficient and clear information on fees and pricing drivers to prevent discriminatory practices and enable potential and actual clients to make informed choices.</li> <li>✓ Need to enhance data reporting to ESMA to enable more effective supervision.</li> </ul>	<ul style="list-style-type: none"> <li>✓ Costs are a key factor of the fee-setting process.</li> <li>✓ Thorough cost monitoring crucial to ensure cost-based pricing.</li> <li>✓ Regular review and controls (i.e. on costs and their relation to fee; on deviation from fee schedules) to ensure cost-based and non-discriminatory fees are applied.</li> </ul>	<ul style="list-style-type: none"> <li>✓ Additional challenges and risks posed by credit rating-related services provided by entities related to the registered CRAs.</li> <li>✓ ESMA to ensure it has sufficient and relevant information.</li> </ul>
Key Observations	<ul style="list-style-type: none"> <li>! Discrepancies between theoretical price (fee-schedule) &amp; actual price charged.</li> <li>! Lack of clarity on drivers of price changes.</li> <li>! Insufficient information currently available in ESMA's repository.</li> </ul>	<ul style="list-style-type: none"> <li>! Cost tracked at a high-level of aggregation, not used or usable in practice for the fee-setting process.</li> <li>! Lack of internal controls to ensure compliance with regulatory provisions on fees.</li> </ul>	<ul style="list-style-type: none"> <li>! Few CRAs have significant market power. Their credit ratings are not substitutable services.</li> <li>! For some CRA groups, rating-related services (e.g. rating data delivery and licence to use ratings) are commercialised by entities related to registered CRAs with no controls from the registered CRA.</li> </ul>







# Fees charged by Credit Rating Agencies and Trade Repositories

**FACT SHEET**  
on the Thematic Report

Key observations and areas of supervisory focus



## Trade Repositories

<b>Area</b>	 <b>Transparency of fee schedules</b>	 <b>Fee setting and cost monitoring</b>
	<b>Supervisory Focus</b>	<ul style="list-style-type: none"> <li>✓ <i>Clear</i> - simple, understandable, containing explanatory examples.</li> <li>✓ <i>Comparable</i> - enabling to compare prices of services across TRs.</li> <li>✓ <i>Consistent</i> - using definitions that have common understanding in the industry.</li> <li>✓ <i>Comprehensive</i> - containing all the information necessary for a client to estimate its reporting cost.</li> </ul>
<b>Key Observations</b>	<ul style="list-style-type: none"> <li>❗ Level of detail and definitions used in the fee schedules differ.</li> <li>❗ TR fee schedules are difficult to compare.</li> <li>❗ Lack of information on all costs for a client, i.e. establishing access and connectivity.</li> </ul>	<ul style="list-style-type: none"> <li>❗ No consistent practices in monitoring costs of TR services.</li> <li>❗ Most TRs take advantage of the group support.</li> <li>❗ Fees, including fee caps, are often based on strategic and practical considerations rather than the costs.</li> </ul>