Commission Implementing Decision (EU) 2019/1284 of 29 July 2019 on the recognition of the legal and supervisory framework of Hong Kong as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies (Text with EEA relevance)

COMMISSION IMPLEMENTING DECISION (EU) 2019/1284

of 29 July 2019

on the recognition of the legal and supervisory framework of Hong Kong as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies[(1)], and in particular Article 5(6) thereof,

Whereas:

(1) Article 5(6) of Regulation (EC) No 1060/2009 empowers the Commission to adopt an equivalence decision where the legal and supervisory framework of a third country ensures that credit rating agencies ('CRAs') authorised or registered in that third country comply with legally binding requirements set out in that Regulation and which are subject to effective supervision and enforcement in that third country.

(2) The purpose of this equivalence decision is to allow CRAs from Hong Kong, as far as they are not systemically important for the financial stability or integrity of the financial markets of one or more Member States, to apply for certification with the European Securities and Market Authority ('ESMA'). This equivalence decision offers the possibility for ESMA to assess those CRAs on a case-by-case basis and to grant an exemption from some of the organisational requirements for CRAs active in the European Union, including the requirement of a physical presence in the European Union.

(3) In order to be considered as equivalent the legal and supervisory framework of a third country is to fulfil at a minimum the three conditions set out in Article 5(6) of Regulation (EC) No 1060/2009.

(4) On 28 April 2014, the Commission adopted Implementing Decision 2014/249/EU[(2)], observing these three conditions are fulfilled and considering the Hong Kong legal and supervisory framework for CRAs as equivalent to the requirements of Regulation (EC) No 1060/2009 in force at that time.

(5) According to the first condition laid down in Article 5(6) of Regulation (EC) No 1060/2009, CRAs in a third country must be subject to authorisation or registration and

must be also subject to effective supervision and enforcement on an ongoing basis. The Hong Kong legal and supervisory framework requires CRAs and their rating analysts who provide credit rating services in Hong Kong must have a license for providing credit rating services and are subject to supervision by the Securities and Futures Commission (SFC) of Hong Kong. The Hong Kong legal and supervisory framework endows SFC with a comprehensive range of powers allowing it to investigate whether CRAs comply with their legal obligations. The SFC can compel both unregulated and regulated persons to produce information and documents relevant to the investigation, including trade records, bank records, telephone records, internet records and beneficial ownership information. This power applies to both persons under investigation or whom the SFC has reasonable cause to believe are in possession of information relevant to the investigation. In addition, where there is fear of destruction or removal of evidence, flight of target or other concerns, the SFC has the power to access private premises of both unregulated and regulated persons upon the grant of a search warrant by a judicial authority. In addition, the SFC has a full range of powers to take criminal, civil, administrative and other actions. This includes the administrative power to impose disciplinary sanctions against persons licensed or registered with the SFC, to impose restrictions on licensed or registered persons regarding their business activities, to revoke or suspend a licensed or registered person's licence or registration and to reprimand, impose obligations or fine the licensed or registered person. The SFC has the power to apply to the relevant court for injunctive or remedial orders. The SFC conducts, in addition to onsite inspections, offsite supervision through interactions with licensed CRAs to understand their business models and plans and the risks inherent in such activities, with a view to identifying and assessing the risks arising from their business activities. Information on licensed CRAs is collected through filings with the SFC, including but not limited to annual audited accounts and annual control review reports. The SFC follows up on complaints and self-reported breaches. The cooperation agreement concluded between ESMA and SFC provides for information exchange with regard to enforcement and supervisory measures taken against cross border CRAs.

(6) According to the second condition laid down in Article 5(6) of Regulation (EC) No 1060/2009, CRAs in a third country must be subject to legally binding rules which are equivalent to those set out set out in Articles 6 to 12 of Regulation (EC) No 1060/2009 and Annex I to that Regulation. The Hong Kong legal and supervisory framework lays down detailed corporate governance requirements. The board of directors and responsible officers for the regulated activities bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the CRA. CRAs must have two responsible officers, both of whom have to be approved by the SFC, and at least one of them has to be an executive director under the SFO. Extensive provisions are in place regarding conflicts of interest, requiring CRAs to identify and eliminate or manage conflicts of interest and to be organised in a manner that ensures its business interest does not impair the independence and accuracy of its credit ratings as well as organisational requirements, including outsourcing, record keeping and confidentiality. In terms of organisational requirements, CRAs must fulfil such as those regarding policies and procedures for ensuring compliance with legal obligations and a permanent and

effective compliance function. CRAs are also required to establish a review function responsible for periodically reviewing rating methodologies and models and significant changes thereto. The Hong Kong legal and supervisory framework contains a broad range of disclosure requirements, such as public disclosure of the ratings and annual public disclosures on the rating and ancillary activities. Therefore, the Hong Kong legal and supervisory framework is considered as equivalent to the CRA Regulation in respect of the management of conflicts of interest, the organisational requirements, the quality of ratings and of rating methodologies, the disclosure of credit ratings and the general and periodic disclosure of credit rating activities. It thus should provide for equivalent protection in terms of integrity, transparency, good governance of CRAs and reliability of the credit rating activities.

(7) According to the third condition laid down in Article 5(6) of Regulation (EC) No 1060/2009, the regulatory regime in a third country must prevent interference by supervisory authorities and other public authorities of that third country with the content of credit ratings and methodologies. There is no legal provision empowering SFC or any other public authority to influence the content of credit rating or methodologies.

(8) The Hong Kong legal and supervisory framework still fulfils the three conditions originally laid down in Article 5(6) of Regulation (EC) No 1060/2009. However, Regulation (EU) No 462/2013 of the European Parliament and of the Council[(3)] introduced additional requirements for CRAs registered in the Union making the legal and supervisory regime for those CRAs more stringent. These additional requirements include legally binding rules for CRAs on rating outlooks, conflicts of interest management, confidentiality requirements, quality of rating methodologies, and the presentation and disclosure of credit ratings.

(9) Pursuant to point (1)(b) of the second paragraph of Article 2 of Regulation (EU) No 462/2013, the additional requirements apply for the purposes of assessing the equivalence of third country legal and supervisory frameworks from 1 June 2018.

(10) Against this background, on 13 July 2017 the Commission requested advice to ESMA on the equivalence of the legal and supervisory framework of *inter alia* Hong Kong with these additional requirements introduced by Regulation (EU) No 462/2013 and its judgement on the material importance of any differences.

(11) In its technical advice published on 17 November 2017, ESMA indicated that the Hong Kong legal and supervisory framework in relation to CRAs includes sufficient provisions to meet the additional requirements introduced by Regulation (EU) No 462/2013.

(12) Regulation (EU) No 462/2013 introduces in Article 3(1)w a definition of a rating outlook and Regulation (EC) No 1060/2009 now extends certain requirements applicable to credit ratings to rating outlooks. Although the Hong Kong legal and supervisory framework does not explicitly recognise rating outlooks as a separate and distinct item from a credit rating, the SFC expects, considering the broad nature of the term ‘credit rating’ under the Hong Kong legal and supervisory framework, the production of rating outlooks to adhere to all of the same requirements for credit ratings.

(13) With a view to enhancing the perception of independence of credit rating agencies vis-à-vis the rated entities, Regulation (EU) No 462/2013 extends in Article 6(4),6a and 6b of Regulation (EC) No 1060/2009 the rules on conflicts of interest to those caused by shareholders or members holding a significant position within the CRA. The Hong Kong legal and supervisory framework requires CRAs to establish appropriate and effective arrangements as to prevent, identify and eliminate or manage and disclose conflicts of interest and to ensure they are not affected by business relationships. Although there is no explicit reference to shareholders in the Hong Kong legislation, if there is potentially a conflict of interest then the CRA is prohibited from carrying out that business.

(14) Regulation (EU) No 462/2013 introduces new provisions to ensure that confidential information is only used for purposes related to credit rating activities and is protected from fraud, theft or misuse. To that effect, Article 10(2a) of Regulation (EC) No 1060/2009 requires CRAs to treat all credit ratings, rating outlooks and information relating thereto as inside information up until the point of disclosure. By establishing detailed requirements, the Hong Kong legal and supervisory framework requires CRAs to adopt procedures and mechanisms to protect the confidential information relating to issuers. There is thus a credible framework in place to protect against the misuse of confidential information.

(15) Regulation (EU) No 462/2013 aims to increase the level of transparency and quality of rating methodologies. It introduces in Annex I, Section D, Subsection I paragraph 3 of Regulation (EC) No 1060/2009 an obligation for CRAs to provide a rated entity with the opportunity to indicate any possible factual errors ahead before publication of the credit rating or the rating outlook. By placing a higher priority on the rating being communicated to the market without delay, the Hong Kong legal and supervisory framework contains no strict requirement for CRAs to inform a rated entity about a credit rating prior to its publication. Instead, CRAs are to only inform a rated entity of the critical information and principal considerations upon which a rating will be based when feasible and appropriate.

(16) Regulation (EU) No 462/2013 introduces safeguards in Article 8(5a)(6) aa and ab and (7) of Regulation (EC) No 1060/2009 to ensure that any modification to rating methodologies does not result in less rigorous methodologies. The Hong Kong legal and supervisory framework requires that CRAs fully and publicly disclose any material modification to its methodologies. In addition, it requires that where feasible and appropriate the CRA is to disclose such material modifications prior to their going into effect. Should there be any change to methodologies, models or key rating assumptions used in preparing any of its credit ratings, the CRA is required to immediately disclose the likely scope of credit ratings to be affected using the same means of communication as was used for the distribution of the affected credit ratings.

(17) Regulation (EU) No 462/2013 strengthens the requirements regarding the presentation and disclosure of credit ratings. Pursuant to Article 8(2) and Annex I, Section D, Subsection I paragraph 2a of Regulation (EC) No 1060/2009 a CRA shall accompany the disclosure of rating methodologies, models and key rating assumptions with clear