

CONSULTATION ESMA – MARCH 19, 2019  
GLOBAL WARNING  
Michel LEPETIT  
Michel.lepetit@global-warning.fr

CONSULTATION ON DISCLOSURE REQUIREMENTS APPLICABLE TO CREDIT RATINGS  
<https://www.esma.europa.eu/press-news/consultations/consultation-disclosure-requirements-applicable-credit-ratings>

Comment : There is an issue regarding the numbering of the questions ? Question 3 is missing ?

Q1 Do you agree with the proposed Guidelines for press releases that accompany credit ratings or rating outlooks? If not, please explain.

I am not sure the question is a key question regarding the issue of “Credit rating agencies and sustainable finance”.

Q2 Do you agree that a standardised scheme indicating the rated entities level of participation would be beneficial? Do you have any comments on the proposed standardised scheme?

I am not sure the question is a key question regarding the issue of “Credit rating agencies and sustainable finance”.

Q3 Do you have any comments on specific items under this section? If yes please explain with reference to the proposed item’s number

I am not sure the question is a key question regarding the issue of “Credit rating agencies and sustainable finance”.

Alternative :

ESMA Paragraph §35 evokes the issue of methodology and credit rating

- 1) In light of the importance of credit ratings produced in third countries and used in the EU, it is important for ESMA to ensure that endorsed credit ratings meet the same high standards as credit ratings issued in the EU.
- 2) Three non EU Credit rating agencies (CRAs) have very large market shares (see ESMA annual reports), despite the European Union ambition to address this issue when the ESMA became responsible for CRAs after the 2008 Great financial crisis.
- 3) Endorsement is a regime under ESMA regulation which allows credit ratings issued by a third country CRA, to be used for regulatory purposes in the EU. According to

ESMA, more than two thirds of the credit ratings that can be used for regulatory purposes in the EU are introduced through the endorsement regime, as endorsement is used by the leading CRAs (mostly for non-EU issuers and financial instruments).

- 4) UE expect that endorsed credit ratings meet the same high standard as credit ratings issued in the EU. Specifically, EU wants to be sure that regulatory authority and any public authority will not interfere with the content of credit ratings and methodology. And that this methodologies, models and key rating assumptions used are rigorous, continuous and thorough.
- 5) History : The leading CRAs have not demonstrated in the past their ability to prevent methodological failures, and some were heavily convicted and punished following the Great Financial Crisis.
- 6) This failure regarded the risk analysis and understanding of American subprime credit markets. Note that the leading CRAs had strong historical, capital and market links with the United States at that time.
- 7) Climate change risk (physical risk and transition risk) analysis and understanding is a very complex issue. It is a challenge requiring highly specialized and skilled teams of experts and economists.
- 8) There is no backtesting for transition risks, as the transition to a low carbon economy is an unprecedented event. Regarding climate change transition risks, leading CRAs have no specific advantages and their large database are mostly useless for transition risk analysis and modelling.
- 9) More specifically, transition risk must take into account scenarios (see for instance 2017 TCFD report (annex) for the FSB). These scenarios are usually based on country commitments agreed in the context of the 2016 international Paris Agreement : Nationally Determined Contributions (NDC).
- 10) In any country that is non-signatory of the Paris Agreement, or that would withdraw from the pact, credit ratings methodology could be either neglected or strongly biased regarding climate change analysis and understanding. In such country, the content of credit ratings could suffer from interference, especially from public authority at the highest level.

**I suggest the ESMA endorsement regime takes into account the ratification of the Paris Agreement, as an exclusion rule.**

Example :

As an example of methodological bias by a leading CRA, I provide the very recent following methodology update regarding the insurance industry. Among the finance industry, the insurance industry is of course at the forefront of the climate change challenge, both in P&C

(physical risks) and life & savings (transition risks for the investments portfolio). See FSB TCFD report for the G20.

This leading CRA is located in the USA, which is scheduled to withdraw from the Paris Agreement in November 2020.

The rating methodology text is 33 pages : “Request For Comment: Insurers Rating Methodology”, December 3, 2018.

One has to search deeply to find anything regarding climate change in this “insurer” methodology.

The words “climate”, “carbon”, “transition” are absent. “catastroph” is present 3 times, which is a minimum for P&C insurance ...

Q4 Do you have any comments on the proposed Guidelines under this section?

Q5 Are there any additional actions that CRAs could take to improve the disclosure of the consideration of ESG factors?

#### Additional comment

Regarding ESMA commitment to the climate change issue, through its last report (63 pages) : ESMA’s Supervision – 2018 Annual Report and 2019 Work Programme Credit rating agencies, trade repositories, third country central counterparties, and third country central security depositories

[https://www.esma.europa.eu/sites/default/files/library/msp\\_ar2018\\_and\\_wp2019.pdf](https://www.esma.europa.eu/sites/default/files/library/msp_ar2018_and_wp2019.pdf)

Number of items “Climat” = “carbon” = “sustain” = 0

As the other ESAs, ESMA should be provided much more human and financial resources in order to tackle the climate change challenge.