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European Securities and Markets Authority
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Per Electronic Submission

EUROPEAN SECURITIES AND MARKETS AUTHORITY CONSULTATION PAPER ON GUIDELINES ON DISCLOSURE REQUIREMENTS APPLICABLE TO CREDIT RATINGS (ESMA 33-9-290)

Moody's Investors Service (**MIS**) wishes to thank the European Securities and Markets Authority (**ESMA**) for the opportunity to comment on the Consultation Paper on Guidelines on Disclosure Requirements Applicable to Credit Ratings (the "**Consultation Paper**"). The Consultation Paper raises important policy considerations about the balance between effective disclosure and over-disclosure, and the best way for credit rating agencies (**CRAs**) to strike the right balance.

First, MIS shares ESMA's observation that information regarding how Environmental, Social and Governance (**ESG**) factors are considered in credit ratings is becoming increasingly important to investors.[1] MIS also recognises and appreciates ESMA's view that the proposed Guidelines should not suggest that ESG factors are more relevant to credit risk than non-ESG factors.[2] However, aspects of the proposed Guidelines may inadvertently suggest otherwise,[3] and may also lead to confusion about the nature of CRA credit analysis. In attached Annex I, MIS recommends certain targeted adjustments to the proposed Guidelines to mitigate that risk.

With respect to the second focus of the Consultation Paper regarding regulatory disclosures required under the EU CRA Regulation (**CRAR**)[4], MIS supports ESMA's objective of ensuring a high level of transparency around credit ratings through appropriate

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1 MIS is a signatory to the Principles for Responsible Investment ESG in Credit Ratings Statement, *available at* https://www.unpri.org/credit-ratings/statement-on-esg-in-credit-ratings/77.article.

2 MIS notes that the proposed Guidelines are drafted with a view to supporting the European Commission's Action Plan for Sustainable Finance (8 March 2018), *available at* https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0097.

3 *See e.g.* Section 3.2(8)(ii)(b) of the proposed Guidelines (requiring disclosure where ESG is *not* a relevant credit factor).

4 Regulation (EC) No 1060/2009 of the European Parliament and of the Council as amended by Regulation (EU) No 513/2001 and Regulation (EU) No 462/2013.

and well-structured disclosure across CRAs. However, in addition to the credit rating announcement[5], there are a number of channels available to CRAs to effectively communicate regulatory disclosures about credit ratings to market participants. While the credit rating announcement is central among them, its key function is to inform the market of a change to a credit rating or outlook, together with concise and clear information as to what prompted the change. The focus in the Consultation Paper on the credit rating announcement as the preferred or exclusive means of regulatory disclosure disregards other effective mechanisms, and risks making the credit rating announcement overly lengthy, complex and less helpful to users of credit ratings.

We have three primary observations on this section of ESMA's proposed Guidelines:

1. **The proposed Guidelines should not restrict CRA website registration.** The Consultation Paper suggests disclosure information should not be "placed behind a registration barrier or pay-wall." While we fully agree that access to regulatory disclosures should not be contingent on payment, free website registration is not a "barrier" to access but rather serves important purposes, and should be permitted under the proposed Guidelines.

2. **The proposed Guidelines should support the purpose of the credit rating announcement.** A key function of the credit rating announcement is to provide users of credit ratings with information about the key factors underlying credit rating actions[6]. While credit rating announcements are an effective vehicle for making certain regulatory disclosures, this key function will be undermined if it becomes overwhelmed with highly granular disclosure information that can be made available and accessible through other channels.

3. **The proposed Guidelines should reduce, not increase, the complexity of regulatory disclosure.** The Consultation Paper suggests that CRAs should leverage the credit rating announcement to provide variable disclosures that apply at the issuer or individual debt instrument level. This would result in disproportionately long credit rating announcements, or alternatively, exponentially more credit rating announcements about the same credit rating action. Either outcome would be confusing to the market and result in reduced, rather than increased, transparency.

In attached Annex I, we discuss these views in further detail, and provide alternative approaches to the proposed Guidelines. In Annex II, we provide MIS's responses to the specific questions posed in the Consultation Paper on ESG disclosure, as well as the proposed Guidelines for disclosures to be made in the credit rating announcement. Annex III contains proposed amendments to the text of the proposed Guidelines.

5 "Credit rating announcements" are the written documents through which MIS publicly announces information about its credit rating actions. We note that the CRAR and the Consultation Paper refer to the "press release" or "press releases". At MIS, the term "press release" may refer to public announcements unrelated to credit rating actions. For clarity, we refer to "credit rating announcements" in this submission.

6 A credit rating action includes: the assignment of a credit rating; a change in a credit rating (i.e., upgrade or downgrade); placing a credit rating on review, changing the direction of an existing review or taking a credit rating off review (i.e., credit rating confirmation); the assignment or change in an outlook; an affirmation of a credit rating; and a withdrawal of a credit rating.

We thank you for your consideration and would appreciate the opportunity for a follow-up discussion at your convenience.

Yours sincerely

/S/ **Neil Acres**

Neil Acres
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I. Environmental, Social and Governance Factors under the CRA Regulation

A. MIS Credit Ratings Incorporate ESG Factors

MIS has long considered ESG factors in our assessment of credit risk, and we recognise their growing importance to investors. While market thinking in the ESG space evolves, our approach to credit risk continues to incorporate the broadest possible and most forward-looking view into all material considerations, including ESG factors, that can affect the credit quality of an issuer or sector.[7] We identify and assess credit implications arising from all material ESG considerations that we can discern, whether they have a current impact or a potential future impact.[8]

At the outset, it is important to note that credit ratings and ESG assessments[9] answer different questions, and should not be conflated. While MIS considers ESG factors in its credit rating analysis, in order to be material from a credit perspective, ESG factors must impact the likelihood of default and credit loss. The materiality of a particular aspect of ESG might be unique to a specific sector, issuer or transaction. While ESG factors and their credit implications may manifest in a variety of different ways, our focus remains on whether the ESG factor materially affects borrowers' cash flows, the likelihood that they will default on their debt obligations, and the loss given default. In this regard, our approach to ESG factors is similar to our approach for all other material credit considerations.

Where relevant, MIS incorporates the credit implications of ESG considerations in our credit rating methodologies, and in the credit rating rationale where they are drivers of a change in the credit rating level or outlook. In order to be transparent and succinct, credit rating rationales illuminate key driving factors, including ESG factors, that prompt a change in the rating level or outlook for the relevant issuer or security. At the same time, credit rating rationales do not focus on the myriad of factors that are unchanged or are not materially credit relevant. That is to say that ESG factors may be considered as part of MIS's credit analysis of an issuer or debt instrument and addressed in the relevant methodology, but those factors may not be a material factor or key driver in a change to the credit rating level or outlook, and therefore may not be specifically cited in the credit rating rationale.

B. MIS Supports Disclosure of ESG Factors that are Material to Credit Risk

The proposed Guidelines call for CRAs to disclose whether and how ESG factors were considered as key underlying elements of a credit rating issuance, and to clearly identify whether the factor or factors were either Environmental, Social or Governance factors. While

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[7] MIS credit ratings reflect judgments about the future default probability of issuers and financial obligations, as well as the potential severity of any financial losses to creditors in the event of default.

[8] *See e.g. MIS Cross-Sector Rating Methodology on "General Principles for Assessing Environmental, Social and Governance Risks* (9 January 2019), *available at* https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569.

[9] ESG assessments address discrete aspects of an issuer or security related to environmental, social, or governance issues. For example, an ESG rating may assess the carbon footprint of an issuer (environmental), how it interacts with the local community in which it operates (social), or its executive leadership's ability to institute effective internal controls (governance).

we agree with the objective of increasing investor understanding as to how ESG factors are reflected in credit analysis, we have three concerns about aspects of the proposals:

(i) ESG disclosures as set out under the proposed Guidelines[10] would be more meaningful with respect to a change in rating level or outlook (i.e., a change in notches) as opposed to the credit rating level itself (in absolute terms);

(ii) the proposed requirement for a negative identification "where ESG factors <u>were not</u> a key underlying element of a credit rating"[11] is likely to mislead investors; and

(iii) a requirement to classify certain ESG drivers as <u>either</u> Environmental, Social or Governance is not consistent with the nature of credit analysis[12].

We address these aspects of the proposed Guidelines below, and suggest alternative approaches that would achieve the same objectives as identified in the Consultation Paper.

C. ESG Disclosure Guidelines should Distinguish Between the Credit Rating and Changes in the Credit Rating Level or Outlook

ESMA proposes two kinds of disclosures in respect of ESG factors: (i) general information as to how ESG factors are considered as part of a CRA's credit analysis[13]; and (ii) ESG information that is specifically relevant to a particular credit rating or a change in rating level or outlook.[14] MIS agrees with the spirit of the proposed two-pronged approach, and has no concerns with the requirements in respect of general information described under (i).

In contrast, the proposed language for the specific disclosures under subsection (ii) may not clearly distinguish between a CRA's general approach to ESG and how ESG factors may impact a change in rating level or outlook. The proposed language appears to require ESG disclosures in respect of credit ratings (in absolute terms), rather than a change in rating level or outlook (i.e., what prompted a change in notches). Given the multiplicity of considerations underlying any given rating, such an explanation would often cover a wide range of factors and would risk to replicate parts of the generic explanations as required under (i). Instead, we would encourage ESMA to adopt final Guidelines that require disclosure of ESG factors where they drive a change in rating level or outlook.

The proposed Guidelines for ESG disclosure refer interchangeably between the "key underlying elements of the credit rating issuance" and the "key underlying element of the credit rating." There is an important distinction to be drawn between factors that may be considered in connection with the credit rating (i.e., the absolute level) and a change in rating

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10 "Outline in the press release whether any of the key underlying elements of the credit rating issuance correspond to that CRA's categorization of ESG factors." Section 3.2(8)(ii).

11 Section 3.2(8)(ii)(a).

12 Section 3.2(8)(ii)(b) (emphasis added).

13 "Include a direct web-link at the bottom of each credit rating action press release to the section of that CRA's website that includes guidance explaining how ESG factors are considered as part of that CRA's credit ratings." Section 3.2(8)(ii)(a).

14 Sections 3.2(8)(ii)(a)-(b).

level or outlook.[15] As discussed in further detail below, a CRA may consider a number of factors in determining the appropriate rating level for an issuer or debt instrument, but only a subset of those factors may be a material driver or key underlying element of a change in rating level or outlook.

If CRAs are required to disclose whether ESG factors are a key underlying element of the credit rating itself (in absolute terms), there is a high likelihood of positive disclosure in almost all instances. ESG factors are often considered by CRAs as part of credit rating analysis and monitoring. For example, the "effectiveness or otherwise of a rated entities' Board of Directors"[16] will always be considered as part of the credit analysis for a corporate issuer. In these cases, if the ESG disclosure obligation is triggered based on consideration of a factor in absolute terms, nearly all credit ratings for corporate issuers would receive a positive ESG disclosure regardless of the weight that factor carried in the analysis. Under such an approach, the broad meaning and the varying significance of the disclosure would undermine its very purpose and would risk to become "boilerplate".

Instead, the ESG disclosure should be applied in way that serves to distinguish certain drivers to a change in rating level or outlook. If CRAs positively and clearly disclose when ESG factors are a key driver of a change in rating level or outlook, investors will have meaningful insight into when ESG factors are material to the CRA's changing view of the credit risk for a particular issuer or debt instrument. If a user of a credit rating seeks additional information about whether ESG factors are considered more broadly in connection with an issuer or debt instrument, there are two potential sources for this information: (1) the publicly disclosed methodology which provides detailed information about how specific factors may be considered; and (2) the dedicated section of the CRA's website that describes its approach to ESG, as described under the proposed Guidelines.[17]

D. Negative Identification will Result in Misleading Disclosure

While MIS does not object to a requirement to indicate where ESG factors <u>were</u> a key element driving a change in rating level or outlook, we are troubled by the proposed requirement that CRAs indicate when ESG factors <u>were not</u> a key element in a change in rating level or outlook.[18] In this respect, we have two primary concerns: (i) ESG factors should not be treated materially differently from other credit drivers; and (ii) a negative identification may incorrectly suggest that ESG factors are not, or have not been, considered by the CRA. Therefore, we suggest this aspect of the proposed Guidelines be omitted from the final Guidelines.

i. ESG factors should not be treated differently than other credit drivers

In no other circumstance are CRAs required to indicate that specific factors <u>were not</u> a key underlying element of a change in rating level or outlook. The proposed Guidelines should not inadvertently suggest to investors that the inclusion or absence of ESG factors is

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15 It was our understanding at the public hearing held on 4 February that ESMA suggested the disclosure should be made in respect of a change in rating level or outlook.

16 *See* paragraph 67 or the Consultation Paper.

17 The first prong of the proposed Guidelines for ESG disclosure whereby CRAs provide a link to a portion of their website that provides information about its approach to ESG factors more broadly. *See* Section 3.2(8)(i).

18 Section 3.2(8)(ii)(a).

somehow more meaningful than the inclusion or absence of other factors. While MIS recognises that ESG factors are becoming increasingly important to investors, ESG factors should not eclipse all other factors relevant to CRA credit analysis. Instead, the CRA disclosure Guidelines should treat disclosure of ESG factors consistently with the disclosure of other key drivers, and require that they be affirmatively disclosed where present and material to a change in rating level or outlook.

ii. A negative identification may incorrectly suggest that ESG factors are not considered by the CRA and is prone to misinterpretation

As noted, ESG factors may be considered as part of credit risk analysis, but may not be a key underlying element or material driver for a change in rating level or outlook. A negative identification statement is likely to be misinterpreted to mean that ESG factors either were not considered, or were not relevant to the credit rating (in absolute terms) – when in reality, they were considered and might be relevant to the credit rating, but were not the key factors behind a change in rating level or outlook. A hypothetical example to demonstrate how this scenario might work in practice:

> An oil and gas producer completes an acquisition that impacted the oil and gas producer's financial profile. The impact of the acquisition to its financial profile prompts a downgrade to the acquiring oil and gas producer. While the main driver behind the change to the credit rating level was a non-ESG specific factor, a statement that ESG factors were not a key underlying element in the rating level change might incorrectly suggest that ESG factors are not relevant to the credit rating, in absolute terms. In fact, a broad number of factors would be considered; including for example, governance structures around the acquisition, or increased environmental liability exposure related to the acquired entity. ESG factors might not have triggered the change in rating level, but they are likely to be part of the credit risk analysis.

In this instance, the negative statement would be particularly confusing to users of the credit rating given that there are no other credit criteria for which such an explanation is required. Given the risk of misunderstanding, it would need to be accompanied by further explanation that would add additional length and unnecessary complexity to the credit rating announcement.

The risk of misinterpretation is compounded by the fact that there is currently no agreed upon standard for what is deemed Environmental, Social or Governance in the broader market.[19] There is also not yet an agreed upon understanding of what standards to apply to these factors, how to measure their impact, over what time horizon, and whether an absolute or relative ranking is the best mode for communicating information. A statement by a CRA that ESG factors were not key underlying elements of the rating level change might be misread by a user of credit ratings who adopts a different interpretation as to what constitutes such factors or what their impact could be. Further, as discussed in more detail below, it may not even be feasible or accurate to clearly distinguish ESG factors from a credit perspective, and the proposed Guidelines could inadvertently contribute to investor confusion about these factors in the meantime.

[19] We note the ongoing efforts by the technical expert group on sustainable finance (TEG) formed under the EC Action Plan to establish the conditions and the framework to gradually create a unified classification system ('taxonomy') on what can be considered an environmentally sustainable economic activity.

E. The Proposed Guidelines Assume Clear Distinctions between Environmental, Social, and Governance Factors

The proposed Guidelines require that CRAs "clearly identify" whether key underlying elements of a credit rating are either Environmental, Social, or Governance factors[20]. While in some instances it might be possible to neatly isolate or catergorise ESG factors for disclosure purposes, that will not always be the case. The proposed Guidelines should accommodate both scenarios.

Different ESG factors may be diffuse or interconnected, and not easily described as "either" Environment, Social or Governance factors. For example, an instance of heavy flooding might cause mass displacement for a sovereign and challenge a government's ability to manage the situation, while also posing immediate and potentially long-lasting environmental damage that may impact public health. In this instance, it would be arbitrary and potentially misleading to require the CRA to identify whether the Environmental, Social or Governance factor is the key driver of a change in rating level or outlook.

While MIS appreciates the objective of providing clear disclosure around how ESG factors are considered, we urge an approach to disclosure that does not artificially define or compartmentalise the complex and evolving issues that are at play. Instead, we suggest that the disclosure guidelines require that where ESG factors are a key element of change in rating level or outlook, the CRA should clearly identify those factors, explain how the factors are material to the CRA's assessment of the credit risk, and why they drove the change in rating level or outlook.

II. CRA Disclosures in the Credit Rating Announcement

The Consultation Paper introduces proposed Guidelines aimed at improving the quality of CRA disclosures in credit rating announcements by promoting consistent and harmonised disclosure across CRAs. The proposed Guidelines are intended to provide transparency into credit ratings and to assist users of ratings to mitigate any mechanistic reliance on credit ratings by enabling the assessments of risks, uncertainties and limitations inherent in a credit rating. MIS supports these objectives, but we are concerned that certain aspects of the proposed Guidelines may create obstacles. Below we set out our three primary concerns with the proposed Guidelines, and suggest alternative approaches to meeting its objectives.

A. The Proposed Guidelines Should not Restrict CRA Website Registration

The Consultation Paper indicates that disclosure information should not be "placed behind a registration barrier or pay-wall."[21] While we fully agree that access to disclosures should not be contingent on payment or subject to multiple registration requirements, we do not consider free registration to the CRA website to be a barrier to access. In fact, website registration serves a number of important purposes, including some which that result from the CRAR.[22]

When MIS assigns an initial credit rating or changes the rating level or outlook on an existing credit rating, the credit rating announcement is made publicly available on MIS's

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[20] Section 3.2(8)(ii)(b) (emphasis added).

[21] Paragraph 23 of the Consultation Paper.

[22] *See e.g.* Article 8(2) of the CRAR.

website (moodys.com or "MDC") to all website visitors. Once published on MDC, the credit rating and related information, including all applicable regulatory disclosures for individual debt instruments, are available to all self-registered users of MDC. Self-registered users have complete access to current and historic ratings on MDC on a look-up basis.[23]

There is no fee charged to become a self-registered user of MDC. To become a self-registered user of MDC, individuals are required to provide their name, company affiliation, country/jurisdiction and a valid email address. Self-registration also requires users to accept Terms of Use, and to demonstrate that they are a live user by completing a "Captcha" verification. This is a one-off process and once logged in, there is no further requirement to obtain access to the information described in the proposed Guidelines.

Self-registration serves a number of important purposes. For example, through the registration process, CRAs can provide users of the website with important information about credit ratings, including disclaimers and explanations about the nature and the limitations of credit ratings, as well as the appropriate usage of ratings (e.g. a clear statement that credit ratings are opinions regarding the creditworthiness of an entity or instrument and should not be considered to be recommendations to purchase, sell or hold particular securities).[24] Self-registration also enables CRAs to ensure that its credit ratings are being accessed by live users rather than bots or other parties intending to scrape information protected by intellectual property rights (for example, ISINs) and to protect content from redistribution for unauthorised commercial use or another unlawful purposes.

Free self-registration is entirely consistent with the CRAR, and provides a reasonable means by which CRAs can monitor access to their websites to protect against unauthorised or illegal use.

B. The Proposed Guidelines Should Support the Purpose of the Credit Rating Announcement

A key function of the credit rating announcement is to provide users of credit ratings with information about the CRA's rationale for a credit rating action, and the analysis that underpins its rationale.[25] While credit rating announcements are also an effective vehicle for making certain regulatory disclosures, this key function will be undermined if it becomes overwhelmed with highly granular disclosure information that is "disproportionate in relation to the length of the report".[26] In light of this risk, the CRAR clearly permits CRAs to make disclosure information available in places outside of the credit rating announcement.[27]

As recognised by the CRAR, there is a trade-off between the volume of disclosure information provided in the credit rating announcement and the utility of that information,

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[23] This refers to the ability of a self-registered user to search for and access individual credit rating using a specific search criteria (e.g., issuer name).

[24] Article 8(2) of the CRAR states, in part: "The credit rating agency shall issue credit ratings and rating outlooks stipulating that the rating is the agency's opinion and should be relied upon to a limited degree."

[25] "When announcing a credit rating or a rating outlook, a credit rating agency shall explain in its press releases or reports the key elements underlying the credit rating or the rating outlook." CRAR, Annex I, Section D, I, 5.

[26] CRAR, Annex I, Section D, I, 5.

[27] *Id.*

and we are concerned that the proposed Guidelines may not strike the right balance. The disclosures that matter most to investors are those that relate to the rating rationale, as implicitly recognised by the CRAR's requirement that they be set out in the credit rating announcement.[28] While we do not discount the value of the additional regulatory disclosures required by the CRAR, there are important reasons to provide them in other ways and through different channels than the credit rating announcement, as recognised by the CRAR.[29] As discussed in further detail below, among the disclosures addressed in the Consultation Paper that fall into this category are those that relate to individual issuers and debt instruments, and pertain to endorsement, solicitation, and issuer and third-party participation.

We suggest that the proposed Guidelines be amended to more clearly align the requirements with the CRAR which allows for certain disclosures to be referenced, but not provided directly in the credit rating announcement, where they would otherwise be disproportionate in relation to the length of the report distributed. This reference can be complemented or combined with a hyperlink to the relevant section of the CRA's website.

C. The Proposed Guidelines Should Reduce, not Increase, the Complexity of Regulatory Disclosure

The Consultation Paper notes that the CRAR disclosure requirements must generally be made in the credit rating announcement and that this is typical industry practice.[30] However, CRAs vary widely in size, as do the types of issuers and amount of debt issuance they rate. Naturally, CRAs operationalise their disclosure processes in accordance with the structure and nature of their business, and the types of issuers and debt they rate. The proposed Guidelines should accommodate a certain degree of flexibility in how CRAs meet these disclosure obligations.

Credit rating announcements announce credit rating actions that may involve several issuers and multiple debt instruments. Even credit rating announcements relating to credit rating actions impacting one issuer may involve multiple individual debt instruments. For example, in 2018, MIS published nearly 15,000 credit rating announcements relating to almost 170,000 credit ratings on issuers and debt instruments. In other words, each credit rating announcement on average covered more than 11 individual ratings. However, the Consultation Paper suggests that CRAs should leverage the credit rating announcement to provide variable disclosures that apply at the individual debt instrument level (e.g. endorsement; solicitation status). Under this approach, the proposed Guidelines would result in:

(i) publication of, on average, 11 separate credit rating announcements for the same credit rating action in order to accommodate regulatory disclosures for individual issuers or single debt instruments; or alternatively,

(ii) credit rating announcements populated with a long tail of technical information broken down by debt instrument.

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[28] *Id.*

[29] *Id.*

[30] *See* Paragraphs 24-25 of the Consultation Paper.

In the first instance, users of credit ratings would need to access and review multiple credit rating announcements for the same credit rating action to find the information that relates to specific issuers or debt instruments. In the second instance, the single credit rating announcement would be dominated by granular regulatory disclosures, and would leave users of credit ratings with an overly cumbersome and unmanageable document. It would also require complex systems to process the information, which may raise significant feasibility challenges for CRAs. Both outcomes would be at odds with the underlying objectives of CRA disclosure and specifically, with the provision in the CRAR that provides where information would be "disproportionate in relation to the length of the report distributed, it shall suffice to make clear and prominent reference […] to the place where such disclosures can be directly and easily accessed"[31].

We also note that some of the disclosures addressed in the proposed Guidelines can change over time, independent of a credit rating action and without an impact on the credit rating. For example, the endorsement status of an outstanding instrument might change from "EU Rated" to "EU Endorsed", or alternatively, from "EU Endorsed" to "Not EU Endorsed." Similarly, a credit rating may initially be solicited by the rated issuer, but subsequently become unsolicited because the rated entity no longer seeks to have the credit rating maintained. These changes can occur without a change to the credit rating, and without an accompanying credit rating announcement. It would be unnecessarily confusing to the market and would create unnecessary noise if this was to trigger the need to issue a new credit rating announcement on an issuer level, or even at the instrument level, even though there was no change to the relevant credit ratings.

Finally, it is important to highlight that electronic platforms, such as CRA websites, provide users with more flexibility to access the disclosure information they seek. While the credit rating announcement continues to be the central document for providing credit ratings to the public free of charge, including required regulatory disclosures, it is not the only mechanism for the transmission of all types of information. As information technology continues to evolve, so do the ways market participants seek and access information. In many respects, CRA websites may ultimately provide a more dynamic, nimble, and effective means by which CRAs can impart important disclosure information. For example, websites are generally more suitable to providing information in a table format and to structure information in a searchable or sortable format. Going forward, there may be other feasible and effective means to providing effective disclosure. The final Guidelines should be drafted in a way that contemplates and accommodates innovative ways of providing effective and useful disclosure information to users of credit ratings.

Therefore, rather than require that these specific disclosures be made directly in the credit rating announcement, CRAs should be permitted to provide disclosures through other channels, provided CRAs do so in a clear and consistent manner. Consistent with the CRAR, hyperlinks could be directly provided in the credit rating announcement, or alternatively, referenced and clearly described in the credit rating announcement with a straightforward access path. Furthermore, in order to avoid a circumstance where credit rating announcements are overwhelmed with dozens or even hundreds of hyperlinks to specific debt instrument disclosures, the Guidelines should be clear that bespoke hyperlinks are not

[31] CRAR, Annex I, Section D, I, 5.

required in the credit rating announcement. Instead, where hyperlinks are provided, it is permissible that they lead to sections of the CRA website that are evergreen[32] or that can otherwise be easily located over time with sufficient and clear information. A more granular approach to hyperlink disclosure would increase the risk of error as information and systems are updated over time.

Finally, the processes used to support CRA disclosure in the credit rating announcement involve complex internal systems that involve both analytical functions and information technology infrastructure. While it may appear that the proposed Guidelines call for marginal adjustments to CRA process, the reality is that the proposed changes are likely to require a significant expenditure of resource. Given the availability of other disclosure vehicles, it is not clear that the benefits outweigh costs of the proposed Guidelines.

We also note that the timeframe for implementation of the proposed Guidelines is not made clear in the Consultation Paper. To the extent changes to CRA disclosure processes are required, we urge ESMA to allow adequate time for CRAs for implementation. Depending on the nature of the items required in the final Guidelines, this process is likely to take no less than one year to develop, test and implement.

[32] "Evergreen" refers to sections of a website that are unlikely to change over time.

Annex II

I. Disclosure Requirements for Credit Rating Announcement

Question 1. Do you agree with the proposed Guidelines for press releases that accompany credit ratings or rating outlooks? If not, please explain.

As discussed in Section II of Annex I, we are concerned with several aspects of the proposed Guidelines related to disclosures to be made in the credit rating announcement.

- **The proposed Guidelines should not restrict CRA website registration.** Paragraph 23 of the Consultation Paper states that "excluding certain information from the credit rating announcement or report should not negatively affect the readability of the document for investors, nor should this information be placed behind a registration barrier or pay-wall."

  We agree that users should not be required to pay for regulatory disclosures. As set out in Annex I above, we would however be concerned about restrictions placed on the use of website registration in general. Registration fulfils a number of key functions, such as providing users of credit ratings with important information about the nature of credit ratings, as well preventing misuse of the information provided on the website.

  To the extent that ESMA intends to carry through this language into the final Guidelines, we would suggest to clarify the requirement as follows:

  *"nor should this information be placed behind **an additional** registration barrier or pay-wall".*

- **A key function of the credit rating announcement is to provide users of credit ratings with information about the CRA's rationale for a credit rating action, and the analysis that underpins its rationale.** While the credit rating announcement is a central vehicle for making certain regulatory disclosures, its other key function will be undermined if it becomes overwhelmed with highly granular disclosure information that can effectively be made available and accessible through other channels. As discussed in further detail below in response to Question 3, among the disclosures addressed in the Consultation Paper that fall into this category are those related to endorsement, solicitation, and issuer and third-party participation.

- **The proposed Guidelines should reduce, not increase, the complexity of regulatory disclosure.** Credit rating announcements often announce credit rating actions that impact multiple issuers and multiple debt instruments. The Consultation Paper includes a number of proposed Guidelines that would require specific disclosures be made for individual debt instruments all within the credit rating announcement. Under this approach, the proposed Guidelines would appear to require CRAs to:

  (1) publish multiple credit rating announcements for the same credit rating action; or

  (2) populate credit rating announcements with a long tail of technical information broken down by debt instrument.

This outcome is inconsistent with the objectives of the CRA disclosure. Therefore, we suggest that ESMA amend the proposed Guidelines to reflect that certain disclosures are to be referenced in the credit rating announcement where they would otherwise be disproportionate in relation to the length of the report distributed. This reference can be complemented or combined with a hyperlink to the relevant section of the CRA's website.

- **Changes to the CRA disclosure process require adequate time to develop, test and implement.** It is not clear when the proposed Guidelines might take effect. We note that the processes used to support CRA disclosure typically involve complex internal IT systems. In this regard, we urge ESMA to allow adequate time for CRAs to implement the final Guidelines. Depending on the nature of the items required in the final Guidelines, this process is likely to take no less than one year to develop, test and implement.

Question 2. 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?

MIS is concerned with the proposed approach for the following reasons:

(i) In practice, this disclosure relates to both solicitation status and level of the rated entities' participation. Solicitation status, like some of the other disclosure requirements that ESMA addresses in the Consultation Paper, applies at the debt instrument level, whereas credit rating announcements typically cover a range of different instruments and in some cases, different issuers. As noted above, a requirement to include information on the solicitation status in a schematic in the credit rating announcement itself would make the credit rating announcements overly lengthy and less useful to users of credit ratings.

(ii) Credit rating announcements generally do not include schematics or tables because they are difficult to incorporate from a technical perspective, and are intended to be used downstream across a variety of different media platforms that may not be able to support them.

(iii) A schematic or table would potentially amplify the disclosure over others even though it has no specific bearing on the credit rating rationale or the analysis underpinning it.[33]

We would instead suggest that these disclosure items can be made through text only, and made available on portions of the CRA website that are easily located and accessed by either hyperlink or clear reference in the credit rating announcement.

[33] MIS only issues ratings where it is satisfied that it has sufficient information to do so. In fact, the European Banking Authority has analysed the unsolicited ratings of a range of CRAs, including MIS, in respect of whether their unsolicited credit assessments differ in quality from their solicited credit assessments. It concluded that it "has not identified any difference in the quality of solicited and unsolicited credit ratings for the considered ECAIs." *See* EBA Report accompanying the Decision of the EBA confirming that the unsolicited credit assessments of certain ECAIs do not differ in quality from their solicited credit assessments, 17 May 2016, *available at* https://eba.europa.eu/documents/10180/1466166/EBA+Report+on+Unsolicited+Credit+Assessments+%28Article+138+CRR%29.pdf/cab38f50-64c5-4fb8-990c-526de8710540.

Question 3. Do you have any comments on specific items under this section? If yes please explain with reference to the proposed item's number.

i. **Endorsement status.**

Endorsement can vary by debt instrument, whereas credit rating announcements typically cover a range of debt instruments or even issuers. A requirement to include this information for all concerned instruments in the credit rating announcement itself would lead to overly lengthy disclosures. As per our comments under in Annex II and in response to Question 1 above, we would ask ESMA to recognise that certain disclosures can be referenced in the credit rating announcement and made available via a hyperlink or clear reference to the relevant section of the CRA website.

ii. **Solicitation status and level of rated entities' participation.**

Solicitation status can vary by debt instrument and can change over time. A requirement to include this information for all concerned instruments in the credit rating announcement itself would lead to overly lengthy disclosures. We suggest that a reference or hyperlink in the credit rating announcement to a section of the CRA's website where rating-specific disclosures can be located and accessed is more appropriate.

iii. **Requirement to include a table in a credit rating announcement.**

The inclusion of a table in the credit rating announcement raises a number of concerns. Please refer to our comments under Question 2 above.

iv. **Names, job titles and contact details for the persons responsible for the credit rating.**

MIS has no concerns with this requirement.

v. **A reference to all substantially material sources, together with a requirement to footnote any facts or figures.**

We understand ESMA's desire to allow users of credit ratings to understand the reasoning behind credit ratings, as well as their limitations. However, a requirement to footnote facts and figures is not required by the CRAR. It would also be disproportionately onerous and risks interfering with the CRA's ability to undertake timely credit rating actions, and would likely to result in credit rating announcements that are overly lengthy and cumbersome. Consider for example the following extract[34]:

> *"The EU's outstanding debt amounts to €52.8 billion as at end-August 2018 [Footnote], down from €54 billion at year-end 2017 [Footnote], and compared to a peak of €57.4 billion at the end of 2014 [Footnote]. The EU borrows to on-lend to its member states through the European Financial Stabilisation Mechanism (EFSM) and Balance-of-Payments (BoP) financial assistance*

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34 *Rating Action: Moody's affirms European Union's Aaa rating; outlook stable* (14 September 2018), *available at* https://www.moodys.com/research/Moodys-affirms-European-Unions-Aaa-rating-outlook-stable--PR_388799.

programmes [Footnote], or to non-EU neighbouring countries through its Macro-Financial Assistance (MFA) [Footnote]. Out of the total outstanding debt, the bulk (€46.8 billion) is related to financial assistance to Ireland and Portugal under the EFSM [Footnote], for which the last repayments will fall due only in 2042 [Footnote], and maturities could be extended even further [Footnote].

In particular, strong cash balances represent one of the EU's layers of protection. As of August 2018, the EU's treasury cash balance stood at €22.9 billion [Footnote], and since July 2016 the monthly cash balance has not fallen below €10.9 billion [Footnote], fully covering the EU's maturity repayment (includes capital and interest) peak year of 2021 of close to €10.9 billion [Footnote]. An additional layer of safety is that the EU has the flexibility to redirect part of the budget expenditures, amounting to around €50 billion (e.g. structural funds) [Footnote] to cover debt service if required."

In this example, two short paragraphs would have required 12 footnotes for data points that can be easily verified, and that an issuer would have had a chance to correct as part of its review pursuant to the CRAR[35].

It is also unclear whether CRAs would need to seek permission from third-party sources to cite to their material in the credit rating announcement. This could further complicate the process, and delay CRAs from issuing timely credit rating actions.

We also note that publicly available credit rating methodologies already provide additional and detailed information about the various sources and types of information that are considered as part of the credit rating analysis.

Similar to other disclosures, this information could also vary from issuer to issuer and debt instrument. Therefore, we would also encourage a flexible approach whereby CRAs could provide the disclosure information about material sources of in information either in the credit rating announcement or through its website, consistent with its view of the most effective means of making the information available and useable.

vi. The name of the principal methodology and associated models or criteria.

The inclusion of hyperlinks to the relevant methodologies in credit rating announcements is not required by the CRAR, and could involve significant resources to implement and support. In our view, a clear reference to where the applicable methodology can be located on the CRA website would achieve the underlying disclosure objective and the requirement set forth by the CRAR.[36]

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35 "The credit rating agency shall inform the rated entity during working hours of the rated entity and at least a full working day before publication of the credit rating or the rating outlook. That information shall include the principal grounds on which the credit rating or rating outlook is based in order to give the rated entity an opportunity to draw attention of the credit rating agency to any factual errors." CRAR, Annex I, Section D, paragraph 3.

36 *See* CRAR, Annex I, Section D, paragraph I(2)(b); *see also* Annex I, Section E, paragraph I(5).

With respect to naming models and criteria, we suggest that the inclusion of associated models and criteria be subject to a materiality threshold, and further suggest that models and criteria not be subject to the direct hyperlink requirement.

First, we note that the CRAR does not require the disclosure of models *per se*, but rather requires “descriptions of models and key rating assumptions”[37]. This is an appropriate approach because models and other criteria are less meaningful to users of credit ratings when identified in isolation, but are meaningful when applied in a specific context. Therefore, all models and criteria considered material are already described in the applicable methodology. In the absence of this context, disclosure of a model or criteria on a standalone basis or as an independent document may cause confusion for users of credit ratings, as opposed to transparency into the credit rating process.

Second, without the introduction of a materiality threshold, multiple models or criteria could be subject to the disclosure requirement for a single credit rating action, even if they played an incidental role in the credit rating analysis. In this respect, a broad disclosure requirement could be disproportionate to the role of model(s) in the credit analysis.

In our view, rather than by hyperlink, CRAs should disclose information about material models and criteria, including their use and application, embedded in or in connection with a specific methodology. This type of disclosure provides more useful information for users of credit ratings.

vii. Actions or events that could lead to an upgrade or downgrade.

MIS has no concerns with the proposed Guideline.

viii. Explanations as to where users can find information on definitions.

MIS has no concerns with the proposed Guideline.

ix. A statement explaining disclosure to the rated entity.

This disclosure item may vary by issuer and by individual debt instrument, and we would therefore suggest that a reference, together with a hyperlink to the relevant section of the website where credit rating specific information can be located, would be the most effective means for disclosure.

Environmental, Social and Governance Factors under the CRA Regulation

Question 4. Do you have any comments on the proposed Guidelines under this section?

We agree with the objective of increasing visibility and investor understanding as to how ESG factors are reflected in credit analysis. As discussed in Annex I, we have three concerns with the proposed Guidelines contained in the Consultation Paper.

- **ESG disclosure Guidelines should distinguish between the credit rating and changes in the credit rating level or outlook.** We believe that ESMA’s objective of providing greater clarity to the market on ESG credit risks is best served by a focus on

[37] CRAR, Annex I, Section E, paragraph I(5).

a change in rating level or outlook (i.e., the change in notches); rather than the credit rating (i.e., the absolute level). In contrast, the text as currently drafted refers to either the "credit rating", or the "credit rating issuance". Such a wide remit would lack focus and specificity, and would duplicate the requirement proposed under point (i) under which CRAs would already provide a general explanation and a hyperlink to more information related to their consideration of ESG factors.

- **A negative identification will result in misleading disclosure.** MIS has no concerns with a requirement to indicate where ESG factors were a key element driving a change in rating level or outlook. In contrast, we believe that a requirement to indicate when they were not would be misleading to users of the rating for two reasons: (i) ESG factors should not be treated materially differently to other credit drivers; and (ii) a negative identification may incorrectly suggest that ESG factors are not considered when, in fact, they were considered, but were not the key factors behind a change in rating level or outlook. Therefore, we recommend that the final Guidelines exclude the requirement for a negative statement.

- **The proposed Guidelines assume clear distinctions between Environmental, Social, and Governance Factors.** As currently drafted, the guidelines appear to require that CRAs drawing a hard distinction between Environmental, Social, and Governance factors. It is true that all three are different in nature, but they often overlap in practice.

  As a result, MIS would encourage an approach that does not artificially define or compartmentalise the complex and evolving issues that are at play. Instead, we suggest that the Guidelines require that where ESG factors are a key element of a change in rating level or outlook, the CRA should clearly identify those factors, explain how the factors are material to the CRA's assessment of the credit risk, and why they drove a change in rating level or outlook.

Question 5. Are there any additional actions that CRAs could take to improve the disclosure of the consideration of ESG factors?

MIS understands investors' increasing interest in ESG factors and has already taken a range of actions that seek to address that development. This has for example included:

- the publication of a dedicated cross-sector methodology[38];
- ESG-specific research pieces[39];

[38] *MIS Cross-Sector Rating Methodology on "General Principles for Assessing Environmental, Social and Governance Risks* (9 January 2019), *available at* https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569.

[39] *See e.g. MIS Sector In-depth: Environmental Risks – Global: Heat map: 11 sectors with $2.2 trillion debt have elevated environmental risk exposure* (25 September 2018), *available at* https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1135665; *see also MIS Sector In-depth: Cross-Sector - Global: Social issues can be material to private issuers' credit quality but are not typically the primary driver* (20 February 2019), *available at* https://www.moodys.com/research/Cross-Sector-Global-Social-issues-can-be-material-to-private--PBC_1132742.

- a dedicated section of MIS's website providing research and information about its approach to ESG[40]; and
- ongoing discussions with investors and other users of our ratings to further explain our thinking around ESG.

However, we are concerned that there is sometimes a confusion between on the one hand, ESG as a *credit driver;* and, on the other hand, ESG as a *policy objective or an additional selection criterion* for investors. Both are relevant and important, but they serve different purposes and should be used as complements, not as proxies for one another. Indeed, a potential outcome where both were to be confused would reduce investors' ability to take informed decisions and to adjust their portfolio to their specific preferences.

40 *See* https://www.moodys.com/newsandevents/topics/Environmental-Social-and-Governance-ESG-00702C.

Annex III

A. Proposed Amendments to Disclosure Requirements for Credit Rating Announcements

ESMA considers that a credit rating or rating outlook, published within the meaning of Articles 10(1), 10(2),10(5) and Annex I, Section D, I, 1,2,2a and 4 should at least include~~:~~ ***the below-listed information. Where it would be disproportionate in length to include the information in the press release itself, it shall suffice to make clear and prominent reference to the place where such disclosures can be directly and easily accessed, including a hyperlink to the relevant section of the CRA's website.***

i. A statement as to whether or not the credit rating has been endorsed for use for regulatory purposes in the EU in accordance with the CRA Regulation.

ii. A clear statement as to whether the credit rating is an unsolicited credit rating.

iii. In the case of an unsolicited credit rating***:***

a. whether (a) the issuer, (b) a related third party, or (c) neither the issuer, nor a related third party, participated in the rating process; and

b. whether in the rating process, the CRA had access to the accounts of (a) the issuer, (b) the related third party, or (c) neither the issuer, nor a related third party.

~~***the use of the following scheme to clarify the level of the rated entities participation:***~~

~~***[table]***~~

iv. The names, job titles and contact details for the persons responsible for the credit rating together with the name and address of the legal entity responsible for the credit rating.

v. A reference to all substantially material sources used for the report ~~***should be listed at the end of the report. Where a fact or figure is cited in the press release this should be referenced via footnote to the sources listed at the end of the press release***~~.

vi. The name of the principal methodology and associated ***material*** models or criteria used in determining the credit rating are listed alongside dates of applicability or version number ***of the methodology***. For each methodology ~~***or associated model***~~ a direct web-link should be provided to that document on the CRA's website.

vii. A section clearly identified as addressing actions or events that could lead to an upgrade or downgrade of the credit rating accompanied by best and worst-case scenario credit ratings, with dedicated paragraphs addressing factors that could lead to an upgrade, and actions or events that could lead to a downgrade.

viii. An explanatory paragraph outlining where the user of the rating can find information on the definition of each rating category, including definitions of default, risk warnings, etc. If this is on a section of the CRA's website then a dedicated link to that section or document(s) in that section. If this is in a section of the principal methodology, then a reference to the section of the methodology.

ix. A statement explaining whether or not the rating was disclosed to the rated entity and amended following that disclosure.

B. Proposed Amendments to Draft Disclosure Requirements on Environmental, Social and Governance Factors under the CRA Regulation

With regard to the disclosure as to whether and how ESG factors were considered as key underlying elements of a credit rating issuance in accordance with Article 10(1), 10(2) and Section D, Annex I, I, points 2a and 5, CRAs should:

i. Include a direct web-link at the bottom of each credit rating press release to the section of that CRA's website that includes guidance explaining how ESG factors are considered as part of that CRA's credit ratings. [Annex I Section D, I, 2a]

ii. Outline in the press release whether any of the key underlying elements of **a change to** the credit rating **or outlook** ~~**issuance**~~ correspond to that CRA's categorisation of ESG factors. [Annex I, Section D, I, 5] a.

~~**a. Where ESG factors were not a key underlying element of the credit rating, the CRA should include a statement in this regard.**~~

b. Where ESG factors were a key **driver behind** ~~**underlying element of**~~ a **change to the** credit rating **or outlook**, the CRA should clearly identify **these as Environment, Social and/or Governance factors.** ~~**whether the factor or factors refers to either an Environmental, Social or Governance factors.**~~ [Annex I, Section D, I, 5].