To
European Securities and Markets Authority
Submitted via Web

Date: August 4th, 2021

Reference: Consultation Paper on Guidelines on Disclosure Requirements for Initial Reviews and Preliminary Ratings

Dear ESMA,

With reference to the Consultation Paper on "Guidelines on Disclosure Requirements for Initial Reviews and Preliminary Ratings" dated 26 March 2021, we are pleased to hereby provide the views of our association.

Based on our review of existing CRA disclosures on this topic, we note a high degree of differences across the CRAs in terms of timeliness, periodicity, historic content and accessibility. Furthermore, some CRAs include a statement regarding confidential information: "In order to avoid the possibility of disclosing confidential information, a transaction will be included after it has been announced publicly." Finally, one dominant CRA explicitly mentions that "these disclosures are made where the agency does not ultimately publish a rating". We therefore welcome ESMAs effort to provide a common understanding on Initial Reviews or Preliminary Ratings and the disclosure requirements linked to these.

In this response letter, we are providing responses to all questions raised to CRAs. We hope that our views and comments will assist ESMA in developing a final guideline leading to a common and shared understanding between ESMA and all CRAs to the benefit of all stakeholders, including issuers and investors alike.

ESMA mentions in the consultation paper that it built the proposed guideline based on the common understanding reached at a global level as mirrored in the 2017 IOSCO report on Other CRA Products. Based on the IOSCO report and the terminology used there, ESMA classifies "initial review or preliminary rating" as "non-final other CRA product". At the same time, ESMA does not cite the category of "private other CRA product" as foreseen by the IOSCO report. In order to reach a common understanding, we believe that the differences between private ratings, preliminary ratings and (final) credit ratings are fundamental.

On private ratings

IOSCO defines a Private Other CRA Product as a "traditional Credit Rating offered by a CRA with the exception that a Private OCP is typically made available only to a restricted and controlled number of recipients". The IOSCO report provides a great number of examples of such private OCPs. We confirm that EACRA Members provide such type of services to issuers, so that these can make informed decisions.

This IOSCO definition of Private OCP corresponds to the definition of a private rating under the EU Regulation on CRAs: a private credit rating is "produced pursuant to an individual order and is provided exclusively to the person who placed the order and which are not intended for public disclosures or distribution by subscription". The CRA Regulation explicitly states in Article 2 (2) that these private ratings are not covered by the CRA Regulation. According to Annex I Section B point 7 item f of the CRA Regulation, CRAs are required to keep records of such private ratings – the CRA Regulation therefore neither requires notification to ESMA nor public disclosures of such private ratings.

In § 14 of 2013 ESMA Guidelines and Recommendations of the CRA Regulation, ESMA clarifies the following: "The recipient of a private rating is allowed to share the rating with a limited number of third parties and on a strictly confidential basis – as long as such disclosure does not correspond to public disclosure or distribution by subscription - to ensure that the private rating is not disclosed further. For instance, when applying for a loan, the recipient of a private rating may share his rating with his bank on a strictly confidential basis, or a bank can circulate a private rating to a restricted number of other banks for the purposes of a business transaction."

The IOSCO report on other CRA Products mentions on page 21 the following: "Private - OCPs can convert to Traditional Credit Ratings at the request of the issuer in the case of an issuer rating, or of the issuer of the relevant financial instrument in the case of an issue specific rating. Some larger CRAs reported that conversion to a Traditional Credit Rating requires a new review and vote by a rating committee, whereas another larger CRA advised that conversion to a Traditional Credit Rating occurs simply upon the CRA's approval of the issuer's request." Global CRA Regulators therefore collectively recognize that a private rating being subsequently published upon request of the issuer does not correspond to an "initial review or preliminary rating". We confirm that several EACRA Members provide this option to the issuer within a contractually defined period of time.

On rating shopping

The proposed guideline has the goal to address rating shopping. The concept of rating shopping is captured by recital 41 of the original CRA Regulation: "Credit rating agencies should take measures to avoid situations where issuers request the preliminary rating assessment of the structured finance instrument concerned from a number of credit rating agencies in order to identify the one offering the best credit rating for the proposed structure. Issuers should also avoid applying such practices".

We highlight that CRAs are not in the driving seat of this practice – Issuers are making the decisions for which and how many agencies they engage and which products they request from these. The

individual CRA is usually not aware nor informed that other CRAs have been equally engaged by the issuer.

Rating shopping existed on a large scale in the Structured Finance market prior to the Global Financial Crisis. It is therefore not surprising that the original text of Annex I section D part II point 4 of the CRA Regulation focused on "all structured finance products submitted to it (the CRA) for their initial review or for preliminary rating". The terms "initial review" and "preliminary rating" not being defined further means that these two are examples of the same concern. The IOSCO Report cites additional terms such as "conditional rating", "expected rating", "hypothetical rating", "initial rating" or "provisional rating" to name a few.

On the other end of the spectrum, issuers may request assessments from CRAs in order to take informed decisions. Issuers regularly engage CRAs on a confidential basis to provide private ratings or rating ranges for both an (existing or hypothetical) entity or an (existing or hypothetical) instrument. Such assessments are useful benchmarks for issuers in comparing creditworthiness assessments provided by banks or in assessing potential M&A transactions (which may potentially never materialize). We see this as reasonable in the normal decision making process of various stakeholders.

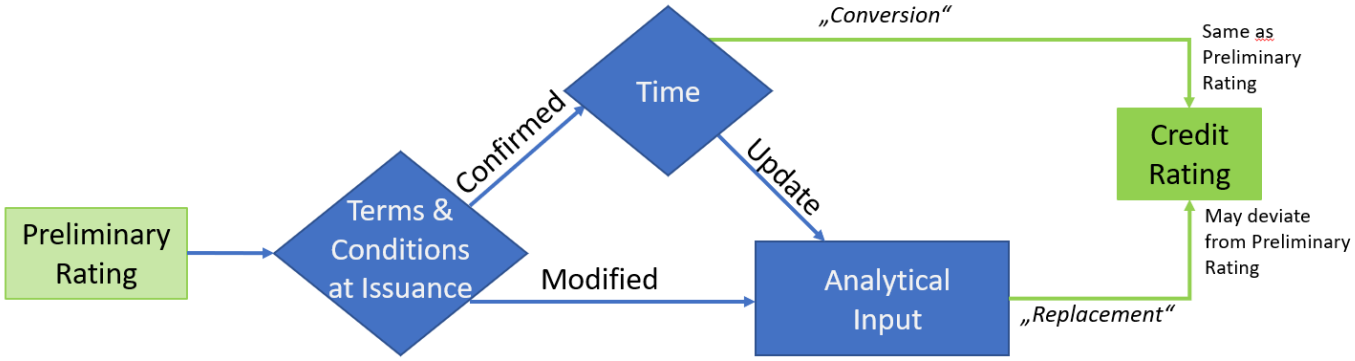
In the context of the implementation of the Basel III reform in Europe, given the proposed introduction of the output-floor, Banks have identified as a key area of concern the high number of unrated corporate issuers. In contrast, we believe that this high number of unrated corporates is driven by the currently unfavourable treatment of high grade corporate exposures. As the Basel III reform proposes to reduce the risk weight of Credit Quality Step 3 corporates (usually associated with a rating in the BBB category) to 75% (compared to the current 100% which is equally applicable to unrated exposures), high grade corporate issuers have a great incentive to get a rating in the medium-term. Given that ratings are sensitive information, corporate issuers will carefully consider all options available to them and may carry out a long process potentially ending with a credit rating. By experience, we note that unlisted and unrated corporate issuers may not be familiar with credit ratings and may potentially not have at hand all the information required to carry out a rating process. Again in this context it is natural for corporates to engage a rating agency to do a private rating before disclosing to the market in a public format.

Our understanding of "initial review or preliminary rating"

Given that the CRA Regulation does not define the terms "initial review" or "preliminary ratings", we hereby share our understanding of this concept based on current market practice:

- A CRA is contracted by an issuer (or its related third party in case of Structured Finance transactions)
- A CRA receives the available set of information including the assumed terms and conditions of the transaction

- A CRA undertakes a full rating process and provides a preliminary rating to the issuer/the instrument subject to terms and conditions of the transaction at issuance



- The rating is made publicly available (or available to subscribers) and the transaction comes simultaneously to the market for pricing
- As soon as the final terms and conditions are set, the lead analyst checks these against the assumptions used. In case where no material differences exist (and that all other rating factors have remained unchanged), the preliminary ratings is confirmed with a credit rating
- In case the final terms and conditions differ from the assumptions used or other rating factors have changed, a CRA will again undertake a full rating process and assign a new credit rating to the transaction.

The above process typically applies to the Structured Finance market but may equally exist in other market segments. During the above process, a CRA is usually not aware whether another CRA is providing a rating until its publication.

Q1 Do you agree that the common understanding would improve the quality of your CRA's disclosures on entities or debt instruments submitted for initial review or preliminary rating? If you do not agree, please explain.

We welcome ESMAs attempt to define "initial review or preliminary rating". We believe that the proposed definition is far too broad and therefore recommend several amendments.

In order to differentiate between "initial review or preliminary rating" and private ratings, we propose to clarify that:

- The "initial review or preliminary rating" has been requested by the rated entity (or its related third party in case of Structured Finance Instruments) and
- The "initial review or preliminary rating" has been subsequently made publicly available or made available to subscribers.

We further believe that point iii, especially the term "if certain conditions are met" and "may be converted into" are too vague. We therefore propose to clarify the following:

- As mentioned in our introductory comment, our understanding of "preliminary ratings" is that these are subject to the final terms and conditions of the issuance. At the time of the "preliminary rating", CRAs will work with assumed terms and conditions. When the

transaction comes to market, the final terms and conditions will be set and CRAs will assess these against the assumptions used. Additionally, we propose to include a wording that "no further substantial rating specific analytical input from a rating analyst is required"

- With regard the term "converted into a final credit rating", we highlight that the CRA Regulation only uses the term "credit rating" – a "final credit rating" is an unknown concept. Additionally, we propose to introduce a fair amount of time reasonable enough, according to the agency's methodology, for the analysis to still be considered updated (eg 3 months), for the replacement of the "preliminary rating" with a credit rating. Such an approach allows for the time required for the issuance to be finalized and for the issuer to receive a credit rating.

Last but not least, we propose to exclude the terms "proposed" and "hypothetical" in point i. A "hypothetical" transaction does not come to the market and should therefore not fall under the provision envisaged here. A "proposed" transaction may equally not make it to the market and can therefore hardly be identified by users of ratings.

In summary, our above proposals would modify the definition as follows:

> For the purpose of the public disclosures that are provided in accordance with Annex I Section D paragraph 6, a CRA is understood as providing an initial review or preliminary rating of an entity or debt instrument when all of the following is met:
>
> i. it has been requested by the rated entity or its related third party in case of SF instruments
>
> ii. it provides a creditworthiness assessment in respect of an issuer or of an existing financial instrument;
> iii. using the same established and defined rating symbology as it would for a credit rating (although a CRA may use a prefix or suffix to denote that the assessment differs from a credit rating);
>
> iv. that has been made publicly available or made available to subscribers
> v. that results in a preliminary or initial assessment which is subject to the terms and conditions at issuance
>
> vi. that may be replaced with a credit rating within a reasonable period of time from the publication of the preliminary or initial assessment if the terms and conditions at issuance are confirmed and no further substantial rating specific analytical input from a rating analyst is required.

Q2 Do you agree that the common understanding is applicable also to initial review or preliminary ratings provided on Structured Finance Instruments? If you do not agree, please explain

As mentioned in our introductory comment, our understanding of "initial review or preliminary rating" typically applies to the Structured Finance market.

Q3 Do you agree that the common understanding is reflective of your interactions with CRAs and would capture the broad spectrum of assessments that would be provided prior to assigning a credit rating?

While this question is addressed to issuers and users of ratings, we need to provide our views on the "broad spectrum of assessments that would be provided prior to assigning a credit rating"

First, we again highlight that "private ratings" are not covered by the CRA Regulation. CRAs may none-the-less run the full rating process in delivering such a private rating to the issuer in order to provide on a confidential basis a rating to the issuer. Several EACRA Members give the option to the issuer to publish this private rating as long as the analysis is up to date – with the publication, the private rating becomes a credit rating fully subject to the CRA Regulation. IOSCO confirms in its report on Other CRA Products that such private ratings are private OCPs and are not classified as Non-Final OCP.

Additionally, CRAs may provide a wide range of products in order to respond to issuers needs such as:

- A CRA may provide an estimate of a rating solely based on historic financial information without assessing the qualitative rating factors.
- A CRA may provide a rating range covering both the qualitative and quantitative analysis
- A CRA may provide rating impact assessments of envisaged transaction.

All the above examples do not match the concept of "initial review or preliminary rating" as 1) the full rating process was not carried out, 2) the information provided is not as rich as the credit rating information package and 3) the issuer has not the option to convert these into a credit rating. Instead, these products provide a guidance to the issuer, who may thereafter engage a CRA for a private rating or a credit rating. This view is confirmed by ESMA Guideline on the Scope of the CRA Regulation dated July 2013: "A measure of creditworthiness derived from summarising and expressing data based only on a pre-set statistical system or model, without additional substantial qualitative rating-specific analytical input from a rating analyst should not be considered as a credit rating."[1]

Q4 Do you agree that the information to be disclosed is feasible and that it will improve the quality of your CRA's disclosures in this area? If you do not agree, please explain.

ESMA expects CRAs to disclose the following information with regard to preliminary ratings or initial reviews:

i. The name of the entity or debt instrument.

ii. The LEI or ISIN of the entity or debt instrument.

[1] See § 13 page 5 of ESMA/2013/720 dated 30 July 2013 on "guidelines and recommendation on the Scope of the CRA Regulation" available at https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-720_en.pdf

iii. The segment / asset class of the entity or debt instrument.

iv. The date the initial review or preliminary rating was provided.

With respect to point I, we note that the current disclosures by CRAs include such names as “BidCo”, “HoldCo”, “TopCo” or names of Special Purpose Vehicles – such names are commonly used in the structuring of Leveraged Buy Out transactions but actually don’t provide any indication on the target of the transaction. Such disclosures therefore don’t contribute to more transparency.

With respect to point ii, we bring to the attention of ESMA that not all entities have currently a Legal Entity Identifier – as an example, an insurance group may be covering all insurance market segments, whereas a CRA may provide specific ratings for specific business lines. With respect to debt instruments, we highlight that hypothetical or proposed transactions do not have ISINs. In our opinion, the disclosure of instruments that do not make it to the final stages (where an ISIN is assigned) do not provide any value.

We note that the proposed guideline does not require CRAs to disclose the level of the preliminary rating. We confirm that this corresponds to the current practice by CRAs.

The proposed guideline is unclear regarding the historic content of the disclosures. While 2 Dominant CRA disclose only the preliminary ratings or initial reviews for the specific reporting period, most other agencies include also historic information, some dating back to 3 or more years. Given the target to address potential rating shopping concerns, we believe that such a long look-back period is not meaningful and may actually impact negatively on issuers who potentially envisaged a transaction some time ago but didn’t go ahead with it. We therefore recommend that the disclosures should only relate to the specific reporting period – in case where users request older information, we propose that CRAs should provide an archive containing the historic disclosures.

We also would appreciate a clarification regarding endorsed ratings and whether these fall under the proposed guideline or not. Ahead of an endorsed rating, a preliminary rating may have been issued by another group entity – should these equally be included in the disclosure?

Q6 Do you agree that the proposed timing of these disclosures is feasible and will increase the value of these disclosures? If you do not agree please explain.

We believe that the timing of the disclosures as proposed by ESMA in this consultation need to be far more precise in order to makes these feasible.

For instance, ESMA wishes that the disclosures take place on the first Wednesday of each month. ESMA does not provide any explanation why the first Wednesday was chosen – the CRA Regulation does not define a similar requirement for other disclosures: generally speaking, CRA are mandated to disclose information on a timely manner (in the case of rating actions), at specific dates (eg transparency report within 3 months of the end of the financial year of a CRA, usually end March) or on Friday evening after the closure of trading venues (in the case of sovereign rating actions).

By sticking to "First Wednesday of the month", we believe that CRAs may face logistical challenges, especially when the first Wednesday is also the first day of the month (eg Wednesday 1 September 2021, Wednesday 1 December 2021, Wednesday 1 June 2022, Wednesday 1 February 2023…). Such days may fall on a public holiday in an EU Member State or collide with annual leaves. In view of potential fines associated with the breaches of the CRA Regulation disclosures requirements, CRAs need to ensure that these disclosures are made properly, correctly and in full – such checks and controls require additional time. We therefore propose to use a more flexible approach and to use "until the 15th". Such a flexible approach is especially important to smaller agencies where such updates are done manually and often depend on only one or two persons.

ESMA does further not explain why a monthly rhythm of disclosures was selected. While 2 Dominant CRAs publish their reports on a monthly basis, the third Dominant CRA applies a quarterly reporting period. The later timeframe is equally used by several other agencies currently. In order to reduce the burden on CRAs but also to investors, we propose that a quarterly rhythm should be set.

With respect to point 2, as currently proposed, we believe that CRAs will face tremendous challenges in applying the approach.

First, it is unclear how long CRAs need to monitor whether other CRAs have issued a credit rating of an entity or debt instrument where the CRA has issued a preliminary rating. With reference to § 37 of the consultation, a CRA issuing a preliminary rating on January 15 may be required to make the disclosure in March, April or May depending on the timing of other CRAs credit ratings. Based on the proposed approach, if a public credit rating is delayed to May, the CRA disclosure obligation would drag on to August – as no time limit is foreseen by ESMA, a CRA would need to monitor all other agencies for ever. Extending the timeframe indefinitely for the publication of preliminary ratings will substantially reduce the value of these disclosures to investors seeking to assess in a timely manner whether rating shopping has taken place.

The implementation of the proposed guideline for a CRA introduces a major organisational challenge. Given that the EU Regulation on CRAs applies to all CRAs, market segments and users of ratings across the whole EU, any other CRA may potentially issue a credit rating where the CRA issued a preliminary rating. A CRA would be required to closely monitor the rating activities of all other (currently 26) registered CRAs via their websites, press release or by subscribing to their rating data feeds or subscription services (in case of investor pays agencies). Such a monitoring is technically difficult and costly to implement or, if monitored manually, prone to errors at both the CRA issuing the credit rating and the CRA monitoring the credit ratings (eg a press release by a CRA may end up in the junk mail folder of the monitoring CRA).

In summary, we believe that the following approach would be more appropriate:

- A CRA should make its public disclosures within 15 days after the end of each quarter:
- A CRA should include those entities or debt instruments for which that CRA has provided an initial review of preliminary rating during the quarter under reporting:
    - in the next report if the CRA was informed by the issuer or its related third party that another CRA has issued a credit rating during the same quarter

- In the next quarterly report in all other cases.

Our above proposal is operational viable enough for CRAs to comply with. Additionally, issuers and investors would have the certainty when the latest the corresponding information is being disclosed.

Q10 Do you agree that centralising accessibility to this information will improve the value of CRAs disclosures on an overall basis? If you do not agree please explain.

ESMA proposes to provide a section of the ESMA website links to the respective CRA disclosures and understands this approach as centralising the information.

We note that this proposal is a premiere for ESMA and could be better used in the context of the list of supervised CRAs: currently, the list contains the names of all registered or certified CRAs but does not include any link to the homepage of the concerned agencies.

While ESMAs proposal has the benefit to reduce the users burden in retrieving the disclosures by CRAs, users will still need to review all reports from all CRAs in order to assess whether rating shopping has occurred in a specific case of interest. This proposal does therefore not substantially increase the value for investors.

A central report covering all issuers or financial instruments where a preliminary rating or initial review was provided by any registered CRA would represent the best approach for investors. But, we highlight that the CRA Regulation foresees the centralisation of information for public access only in case of the Central Repository of Ratings and the European Rating Platform. Beyond these two, all public disclosures by CRAs are exclusively done on their own websites.

We agree that the public disclosure at the CRA website should be accessible without the need to register a user account.

Q12 Do you consider there is value in ESMA providing a standardised disclosure template for these public disclosures? Do you have any additional comments on the standardised disclosure template

The proposed standardised Disclosure template includes the fields defined by ESMA and additional 3 fields. These additional three fields are not defined and therefore not clear, which information should be included there. This approach may therefore be used differently by CRAs and therefore results in less standardisation. We therefore recommend to exclude these 3 fields.

With respect to the other fields, we refer to our response to Question 4.

As proposed in our response to Question 4, we recommend that a quarterly reporting period is selected. We therefore propose to amend the template with the following items:

- Include the name of the CRA
- Include the reference period of reporting
- Include the date of publication of the report

- Where a CRA provides a (final) credit rating, Include the date when the (final) credit rating was provided

Q13 Do you have any comments on the preliminary cost benefit analysis?

With respect to the monitoring costs, we believe that these will be too high if the proposed guideline is not amended. We further believe that these monitoring costs weigh higher on smaller CRAs as they need to monitor not only the extensive activities of the Dominant CRAs but also all other registered agencies.

The monitoring exercise could be automated via the RADAR system, where CRAs would report their preliminary ratings and RADAR would alert the respective CRA as soon as a credit rating is transmitted to RADAR. Based on the RADAR alerts received, the CRA would easily produce the required public disclosure.

With respect to disclosure costs, we believe that these will impact heavily on smaller agencies if the monthly rhythm of disclosures is kept. We therefore recommend using a quarterly reporting period.

Concluding remarks

	Private Rating	Preliminary Rating	Credit Rating
Rating Analysis	Full analysis and process	Based on assumed Terms and conditions	Full analysis and process
Type of Rating	„final“	Subject to Terms and conditions at issuance	„final“
Public Disclosure	No Option to issuer	Yes	Yes
Covered by CRAR	No	Yes	Yes
Regulatory use	No	No	Yes

We appreciate ESMAs effort to seek a common understanding regarding “initial review or preliminary ratings” as this will ensure consistent periodic public disclosures across all CRAs to the benefit of investors. Our above comments and responses will hopefully contribute to the finalisation of this guideline. We therefore would like to recall our main points:

- The guideline needs to include a reference to private ratings as defined in Level 1 legislation and explicitly state that these are not covered by the guideline,
- The proposed definitions need to be clear and not include such vague terms as “may convert into” or “under certain conditions”;

- The timing of the disclosures should be modified to a quarterly reporting cycle.

As an additional or alternative route to tackle rating shopping effectively, ESMA could investigate whether disclosures requirements on preliminary ratings should be done by the issuer (or the related third party). Issuers are best placed to inform on how many and which agencies they have engaged for preliminary ratings. In India, such a requirement on issuers was introduced with the amendment of the CRA Regulation there in September 2019. In the US, the July 21st 2021 public hearing by the US House Committee on Financial Services on "Bond Rating Agencies: Examining the Nationally Recognized Statistical Rating Organisations" showed a great consensus for issuers disclosing their selection and use of CRAs. Based on Article 1 § 2 of the CRA Regulation, ESMA could address the Structured Finance market.

We thank you for the opportunity to provide our comments and remain at your full disposal for any clarifications or additional information.

Best regards

Thomas Missong	Michela Stefanini
EACRA President	EACRA Secretary General

About EACRA

The European Association of Credit Rating Agencies (EACRA), set up in November 2009 and registered in Paris, was established to act as a platform for cooperation for EU-based Credit Rating Agencies (CRAs). Our mission is to support and facilitate the compliance of CRAs with regulatory requirements through effective communication, cross-border know how, and the promotion of best practices. In addition, EACRA seeks to promote Credit Ratings and the interests of CRAs across Europe, as well as enhance the financial community and general public's understanding of Credit Ratings.