

4 August 2021

European Securities and Markets Authority (ESMA)
201-203 rue de Bercy
75012 Paris, France

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

To Whom It May Concern:

In relation to your consultation paper on Guidelines on Disclosure Requirements for Initial Reviews and Preliminary Ratings dated 26 May 2021, please find our response below.

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.

Kroll Bond Rating Agency Europe Limited ("KBRA Europe") believes the scope of ESMA's proposed common understanding of initial review or preliminary rating must be revised to provide greater clarity to the capital markets. As an example, for some structured and non-structured finance transactions, some requests for assessments of "hypothetical" financial instruments do not culminate in an actual transaction, and/or the proposed collateral underlying the instrument or structure may be completely hypothetical or otherwise meaningfully changed such that it would be difficult for a CRA to link the hypothetical to an actual deal. Further, the assessment of hypothetical scenarios often takes place far in advance of an actual transaction that is issued into the capital markets, which may make it more difficult to establish a link between an assessment of hypothetical scenarios and an actual transaction. As a result, it might be misleading to investors to link one to the other, especially given ESMA's proposed timing for the release of the information. The disclosure that a creditworthiness assessment of a hypothetical financial instrument was provided to the issuer or a related party could also cause confusion for investors if they were disclosed as an initial review or preliminary rating following the publication of a rating on a structured finance transaction.

CRA's also may have different definitions and interpretations of whether an assessment on a hypothetical instrument can be linked to a specific structured finance transaction, which could lead to additional inconsistencies in disclosure by CRA's that potentially would also be confusing to capital markets participants. In addition, what constitutes an "assessment" may differ enough from CRA to CRA that absent further clarity, the disclosures of the assessments would be too inconsistent to be meaningful to capital markets participants.

Additionally, ESMA's proposals may lead entities and issuers to avoid constructive early engagement with CRA's, especially smaller CRA's, in a way that would meaningfully reduce competition in a manner contrary to the EU CRA Regulation which has a mandate to foster competition among CRA's. These interactions are likely to be negatively affected if issuers know that CRA's are required to disclose them, especially if it is implied that these discussions are incorrectly characterised as rating shopping. Rather, KBRA Europe believes that early-stage interactions among issuers, their related third parties, and CRA's are beneficial to investors and issuers alike because they enable CRA's to better understand the financial instruments presented, allow CRA's to make determinations concerning ratability, and also give CRA's the opportunity to understand developments and changes in the capital markets. The proposed disclosure



obligation would likely have a greater adverse effect on newer or smaller CRAs. Issuers and related parties would be more inclined to limit their discussions to larger CRAs with a greater number of ratings or ratings on similar transactions rather than explore a newer or smaller CRA's methodological approach to the same type of transaction. This would undermine the EU CRA Regulation's mandate to foster greater competition among CRAs.

To clarify the common understanding of what an initial review or a preliminary rating is, KBRA Europe recommends that the scope of ESMA's proposed definition be narrowed to address only those cases where an issuer or related party has formally engaged a CRA to conduct an initial review or to issue a preliminary rating. This change would be consistent with the common understanding already held by most issuers and related parties, CRAs, and investors in the transactions that are required to be disclosed. The signing of an engagement letter for a credit rating is a clear signal that the commencement of the provision of credit rating services has commenced; formalising this standard would lead to consistency and clarity in the capital markets. KBRA Europe proposes the following modification to ESMA's proposed text:

Common Understanding of Initial Review or Preliminary Rating

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, [following the signed engagement of a CRA by an issuer or related party for a credit rating](#):

- i. it provides a creditworthiness assessment in respect of an existing, ~~or proposed or hypothetical~~ financial instrument;
- ii. using the same established and defined rating symbology as it would for a final credit rating (although a CRA may use a prefix or suffix to denote that the assessment differs from a credit rating); [and](#)
- iii. that results in a preliminary or initial assessment that is not a final credit rating but may be converted into (or replaced with) a final credit rating if certain conditions are met.

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.

KBRA Europe believes that a common understanding of initial review or preliminary rating is also applicable to structured finance Instruments, provided, however, that the language stating that common understanding is consistent with the text revisions KBRA Europe proposed in its response to Question 1.

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?

N/A – For Issuers and Users of Ratings

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.

Based on ESMA's proposed common understanding of "initial review or preliminary rating", it will be difficult for any CRA to link an assessment on a hypothetical financial instrument to the name, LEI, or ISIN of a debt instrument that has been publicly rated, and therefore, would not improve, and potentially degrade, the quality of KBRA Europe's disclosures in this area. As noted in KBRA Europe's response to Question 1, a debt instrument may have changed



significantly since the originator first sought feedback on a hypothetical instrument, and ESMA's proposed standard could lead to inconsistencies in CRA disclosures to the detriment of capital markets participants.

Q5. Do you agree that the information to be disclosed here will be of assistance in developing a clearer picture of which entities or instruments have been subject to initial review or preliminary rating? If you do not agree, please explain.

N/A – For Issuers and Users of Ratings

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.

The proposed timing of the disclosures is feasible only if the text of the understanding is modified in the manner proposed by KBRA Europe in its response to Question 1. Even if that modification is made, however, making the necessary disclosures will require CRAs to allocate significant additional resources. Whether the proposed timing will increase the value of the disclosures is dependent on the consistency of the information that is disclosed by all CRAs, and the very question of what is meant by "value," and to whom. We are uncertain of the value, as market constituents have not engaged us in dialogue whether they find the information useful, nor have we found the postings of other CRAs to be of use to us in our operations. We have concerns that ESMA's proposed common understanding of preliminary ratings or initial reviews could cause confusion for capital markets participants and be detrimental to developments and enhancements in capital markets.

KBRA Europe believes that its proposed revisions to the text of ESMA's proposed common understanding of initial review or preliminary rating would establish a more feasible standard, but one that still will require additional resources to meet the requirement in a way that will disproportionately be burdensome for smaller CRAs and will decrease competition amongst CRAs.

Q7. Do you agree that the proposed timing of these disclosures will better enable investors and the market to identify where rating shopping may have occurred? If you do not agree please explain.

N/A – For Issuers and Users of Ratings

Q8. Do you foresee any difficulties with the timing of these disclosures and the timing of your regulatory disclosures to the market?

N/A – For Issuers and Users of Ratings

Q9. What is the value of CRAs disclosing that they provided an initial review or preliminary rating in cases where a final public credit rating is ultimately not provided for an entity or debt instrument?

N/A – For Issuers and Users of Ratings

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.

KBRA Europe agrees that centralising accessibility to this information might increase the value of CRAs disclosures on an overall basis, if only because all the information will be in one place instead of scattered over numerous CRA websites. This may provide users of the information with more context for evaluating the disclosures.



Q11. Do you agree that centralising accessibility to this information will improve your ability to assess whether an entity or debt instrument has been subject to rating shopping? If you do not agree please explain.

N/A – For Issuers and Users of Ratings

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?

KBRA Europe believes there will likely be some gain in value in ESMA providing a standardised disclosure template for these public disclosures, although as our previous comments make clear we believe changes to the proposed rules are advisable to ensure that capital markets participants are seeing like-for-like comparisons.

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

Further to the response to Question 1, ESMA's proposals may lead entities and issuers to avoid constructive early engagement with CRAs, especially smaller CRAs, in a way that would meaningfully reduce competition in a manner contrary to the EU CRA Regulation which has a mandate to foster competition among CRAs. In a market that is already distorted due to the size-biased eligibility criteria for ECB-acceptance that favours larger credit rating agencies, the cost of this potential reduction in competition will only become apparent in the medium term.

The scope of ESMA's proposed common understanding of initial review or preliminary rating would likely require CRAs to hire additional resources to track and link relevant initial reviews or preliminary ratings to determine if, and when, a rating on the transaction was published such that disclosure was needed. In addition to the proposed content of the disclosure, the proposed frequency of publication of the reporting requires additional resources to collate and publish accurate disclosures on a monthly basis. Both the content and frequency of reporting would require substantive analytical, compliance and internal control time, which would decrease the amount of time analysts spend on analysis and increase the burden on compliance and other control functions. This would have a proportionately greater negative impact on smaller CRAs, who do not have existing staff to perform this analysis.