

04 August 2021

By Electronic Submission

CONSULTATION PAPER: GUIDELINES ON DISCLOSURE REQUIREMENTS FOR INITIAL REVIEWS AND PRELIMINARY RATINGS

Moody's Investors Service (MIS) wishes to thank the European Securities and Markets Authority (ESMA) for the opportunity to respond to its Consultation Paper on Guidelines on Disclosure Requirements for Initial Reviews and Preliminary Ratings ("the Consultation Paper"). We agree that rating shopping is a concern, in particular in structured finance transactions. We believe that the market benefits when there is healthy competition based on the quality of credit ratings, not credit rating levels.

We consequently support ESMA's efforts to improve market transparency to provide investors with greater visibility on instances when rating shopping might have taken place.

For its part, MIS adopted an approach to the disclosure requirements of Annex I(D)(I)(6) of the CRA Regulation (CRAR)¹ that focuses on identifying situations where MIS may have been subject to rating shopping. We would welcome an effective outcome of ESMA's work on preliminary ratings and initial reviews where all CRAs disclose at an equivalent level.

To this effect, we have three overarching observations on the Consultation Paper:

1. ESMA's approach to providing guidance on initial reviews and preliminary ratings should thoroughly consider the circumstances that may facilitate rating shopping.
2. The proposed definition of "initial reviews" and "preliminary ratings" warrants greater precision.
3. Some of ESMA's proposed requirements require refinement to ensure their application is reasonable.

We address each of these points below.

- 1. ESMA's approach to providing guidance on initial reviews and preliminary ratings should thoroughly consider the circumstances that may facilitate rating shopping.**

Rating shopping can occur in a variety of forms. Each CRA has different approaches to their engagement with issuers and a range of different products with different features. In order to capture

¹ Regulation (EC) No 1060/2009 on credit rating agencies, as amended.

the spirit behind the concepts of initial review and preliminary ratings, we suggest that ESMA's guidance ought to be led by a thorough understanding of the nature of the interaction between issuers and CRAs that might facilitate rating shopping.

ESMA defines rating shopping as instances "when an issuer engages with a number of credit rating agencies with a view to selecting only those credit rating agencies that will provide the most favourable assessment for the entity or debt instrument". We agree with this definition in principle, though we also believe that rating shopping can occur where an issuer seeks a creditworthiness assessment from one or several CRAs and then decides to proceed to market without a credit rating.

We suggest that instances of possible rating shopping display at a minimum the following characteristics:

- A creditworthiness assessment in respect of a public issuer rating and/ or public debt offering is initiated by the rated entity and is not publicly disclosed, but is sought for the purpose of potentially disclosing it to the market in future;
 - The issuer or financial instrument in question does not currently carry a full credit rating assigned by the CRA that is tasked with providing the creditworthiness assessment (e.g., where some but not all tranches are rated);
 - The creditworthiness assessment is not a final credit rating, but is assigned under a process that is similar to that used for a public credit rating;
 - The issuer decides to withhold the outcome of the creditworthiness assessment when offering the debt instrument on the market.
2. **The proposed definition of "initial reviews" and "preliminary ratings" warrants greater precision.**

Based on the understanding of rating shopping set out under point 1 above, we believe that ESMA's proposed definition for initial reviews and preliminary ratings is too wide and imprecise to deliver on the objective of providing greater clarity and consistency. For example, based on MIS' products:

- ESMA's proposed definition would capture provisional ratings. MIS will often assign a provisional credit rating to an issuer or an instrument when the change to a definitive credit rating is subject to the fulfilment of contingencies² that could affect the credit rating. Provisional ratings are however public, so no rating shopping has taken place. They would instead generate a lot of irrelevant disclosures and dilute the content of the desired disclosures.
- It might capture hypothetical scenarios. We suggest that these should not be in scope, for three main reasons. First, they are a legitimate governance tool. Issuers seek creditworthiness assessments in respect of hypothetical scenarios to aid decision making on e.g. deleveraging or

² Examples of such contingencies are the finalisation of transaction documents/terms where a rating is sensitive to changes at closing. When such contingencies are not present, a definitive rating may be assigned based upon documentation that is not yet in final form. MIS will also often assign provisional ratings to program ratings, such as shelf registrations and medium-term note programs. For provisional ratings assigned to an issuer or instrument, the (P) notation is removed when the applicable contingencies have been fulfilled.

corporate actions³. Secondly, the debt instrument does not yet exist, and never may; meaning that there is no withholding of market-relevant information. On the contrary, there is a risk that CRAs may inadvertently divulge material non-public information, were they required to disclose creditworthiness assessments provided in respect of a debt instrument that is never brought to market. Thirdly, the disclosures would risk being misleading. An issuer might ask different CRAs to provide creditworthiness assessments for different hypothetical scenarios, so the credit ratings would not have been assigned in respect of the same entity or instrument. Note that if a hypothetical scenario assessed is executed by the issuer, we update the public credit rating as applicable.

3. Some of ESMA’s proposed requirements require refinement to ensure their application is reasonable.

There are three technical aspects in ESMA’s proposal that we consider present difficulties to practical implementation.

a. There needs to be an end point to market monitoring.

ESMA suggests that CRAs should make the disclosure in accordance with Annex I Section D paragraph 6 no later than 30 days after the end of the month in which a credit rating was provided for that entity or debt instrument⁴.

In order to make that disclosure, without inappropriately disclosing material non-public information that may not be in the public domain, CRAs have to monitor the market until such time as another CRA assigns a public credit rating to the entity or debt instrument in question. Based on ESMA’s current wording, this market monitoring could be required indefinitely (and no provision is made for the case that the debt is issued unrated).

However, after a certain time period, for a multitude of reasons including changes in the issuer’s business or the broader economic environment, the issuer or debt instrument cannot be considered to be directly comparable to that of the time at which the initial approach was made, meaning that to identify and disclose an instance of potential rating shopping in such circumstances would not be accurate. MIS therefore considers that an indefinite monitoring requirement would both be impracticable and disproportionate, as well as give misleading results. MIS believes that its current practice of monitoring the market for six months strikes a reasonable balance between the underlying objective of identifying potential cases of rating shopping and the need to ensure that such identification and disclosure is an accurate reflection of what has taken place.

³ For the same reason, we also believe that private ratings should not be included in scope. They are equally used as a governance tool and are generally not meant to be shared with third parties. It is our understanding that ESMA’s proposal excludes private ratings.

⁴ Paragraph 37 of the Consultation Paper, “Timing of Public Disclosures”. ESMA’s specific wording proposes that disclosures need to be made “(w)ithin 30 calendar days of when the initial review or preliminary rating was provided unless [the CRA] can determine that a credit rating has not been provided for that entity or debt instrument.” For avoidance of doubt, we would appreciate clarification that this refers to a public credit rating provided by another CRA.

- b. *Website registration is a legitimate tool to allow us to understand who uses our website and make sure they agree with applicable terms and conditions.*

In respect of the accessibility of the required disclosures, ESMA proposes that “the standardised template is published on a section of the CRA’s website that is free from registration barriers”.⁵ We would agree that the information should be accessible free of charge, i.e., not on a subscription basis.

We would not agree that free registration to a CRA’s website constitutes a barrier to access. Rather, website registration is a standard process that allows CRAs to protect themselves against unauthorised or illegal use of their website, such as information scraping. It is a one-off process that is free of charge and merely requires users to provide their name, company affiliation, country/ jurisdiction and a valid email address. Users also need to accept the Terms of Use and to demonstrate that they are a live user by completing a “Captcha” verification. It would be disproportionate to require CRAs to waive their rights in this regard for no discernible reason.

- c. *Creditworthiness assessments cannot unequivocally be matched with specific ISINs/ LEIs assigned to later issuances.*

ESMA suggests that the disclosures should include the LEI or ISIN of the entity or debt instrument.⁶ However, in most cases it will be difficult to establish that a creditworthiness assessment assigned to a specific financial instrument unequivocally corresponds to an instrument that is subsequently brought to market by the issuer. To the contrary, the specific details are likely to vary to a greater or lesser extent, so that in most cases the CRA would find that the issuance is not precisely the same and the ISIN of a published instrument not applicable.

Please find attached our responses to ESMA’s detailed questions in Annex I, and drafting suggestions in Annex II.

We thank you for your consideration.

Yours sincerely,



Jens Schmidt-Bürgel
Managing Director – Head of EU

⁵ Paragraph 41 of the Consultation Paper, “Accessibility of Public Disclosures”

⁶ Paragraph 29 of the Consultation Paper, “Content of Public Disclosures on Initial Review or Preliminary Rating”

Annex I: Responses to ESMA's detailed questions

Common understanding of initial preview or preliminary rating

Questions for CRAs

1. **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 agree that the meaning of "initial reviews" and "preliminary ratings" is unclear and likely to be interpreted in a different way by different CRAs. We also agree that there is scope to work towards greater commonality in the approach to disclosures across CRAs, based on an assessment of their likely relevance in the context of "rating shopping".

However, we believe that the definition proposed by ESMA needs refinement to more effectively address situations that are likely to constitute rating shopping. Please see points 1 and 2 in our cover letter for explanation, and Annex II for our suggestions for possible amendments to the proposed definition.

2. **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.**

We agree. Indeed, we believe that rating shopping is most common for structured finance instruments.

Questions for Issuers and Users of Ratings

3. **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)

Content of public disclosures

Questions for CRAs

4. **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.**

We agree with the proposed content of the disclosures, but would suggest that the requirement to provide LEIs or ISINs should be subject to applicability. In most cases it will be difficult to establish that a creditworthiness assessment assigned to a specific financial instrument unequivocally corresponds to an instrument that is subsequently brought to market by the issuer. To the contrary, the specific details are likely to vary to a greater or lesser extent, so that

in most cases the CRA would find that the issuance is not precisely the same and the ISIN of a published instrument not applicable.

Questions for Issuers and Users of Ratings

5. Do you agree that the information to be disclosed here will help 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)

Timing of public disclosures

Questions for CRAs

6. 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 agree with a schedule of monthly disclosures. We also agree with the spirit of point 2.ii, that disclosures should only be required once that a public credit rating has been assigned to the entity or debt instrument in question by another CRA. We would extend this to cases where an issuer proceeds to market without a public credit rating after seeking a creditworthiness assessment for the instrument in question.

The current wording would require indefinite market monitoring in some cases. We suggest that this should be subject to a time limit and specifically would suggest a period of six months. After that time, the creditworthiness assessment could not be considered to have been provided in respect of the “same” instrument.

Questions for Issuers and Users of Ratings

7. 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)

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

(N-A)

9. 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)

Accessibility of public disclosures

Questions for CRAs

10. 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.

It is not clear to us what ESMA means in respect of “central” accessibility. Importantly, we do not believe that the disclosures would become more accessible or useful outside of the website registration requirement. Registration on our website is a free, quick, one-off process that allows CRAs to protect themselves against unauthorised or illegal use of their website. Please see section 3c of our cover letter for additional considerations.

Questions for Issuers and Users of Ratings

11. 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)

Question for All Respondents

12. 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.

We have no objections to disclosure in line with a standardised template, subject to applicability of the required content.

Cost Benefit Analysis

Question for All Respondents

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

We have no comments on the cost benefit analysis.

Annex II: Drafting suggestions

Definition

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 conditions are met:

- The CRA ~~it~~ provides a non-public creditworthiness assessment in respect of an issuer or an existing, or proposed debt or hypothetical financial instrument that is publicly offered in the market;
- The issuer or debt instrument in question does not currently carry a full public credit rating by the CRA;
- The creditworthiness assessment is provided in response to a mandate by that prospective issuer;
- The prospective issuer provides confidential information as part of this mandate;
- The creditworthiness assessment is expressed using (i) 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); or (ii) another scale that can be mechanically transposed into the CRA's established and defined rating symbology;
- The creditworthiness assessment allows the prospective issuer to make reliable assumptions about the final credit rating that the CRA may assign to the issuer or debt instrument in question, if it provided the CRA with a mandate for a public credit rating;
- The creditworthiness assessment 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.

Content of disclosures

When publishing its public disclosures that are provided in accordance with Annex I Section D paragraph 6, a CRA should ensure that the following points of information are included for each instance where it has provided an initial review or preliminary rating:

- i. The name of the entity or debt instrument.
- ii. The LEI or ISIN of the entity or debt instrument, where applicable.
- iii. The segment / asset class of the entity or debt instrument.
- iv. The date the initial review or preliminary rating was provided.

Timing of disclosures

When publishing its public disclosures that are provided in accordance with Annex I Section D paragraph 6, a CRA should ensure that the list of entities or debt instruments for which they have provided an initial review or preliminary rating is published by:

- The first Wednesday of each month.

CRA should ensure the list is updated to include those issuances or issuers for which that CRA has provided an initial review or preliminary rating:

- Within 30 calendar days of when the initial review or preliminary rating was provided unless it can determine that a **public** credit rating has not been provided **by another CRA** for that entity or debt instrument **and that the debt instrument has not been publicly issued on an unrated basis.**
- If this cannot be determined, it should be included on the list no later than 30 days after the end of the month in which **the CRA determines that a public** credit rating was provided for that entity or debt instrument **by another CRA, or that the entity or instrument was brought to market without a public credit rating.**
- **If the CRA determines that following the assignment of the initial review or preliminary rating, no debt instrument has been publicly issued within a period of six months, no disclosure needs to be made.**

Location of disclosures

When publishing its public disclosures that are provided in accordance with Annex I Section D paragraph 6, a CRA should ensure that:

- Its public disclosures are provided using the standardised template proposed by ESMA.
- The standardised template is published on a section of the CRA's website that **accessible for free from registration barriers.**